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BIG RIVERS ELECTRIC COOPERATIVE FORECLOSURE

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

NOVEMBER 11, 1985—HENDERSON, KY

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BIG RIVERS ELECTRIC COOPERATIVE FORECLOSURE

MONDAY, NOVEMBER 11, 1985

U.S. Senate,
Committee on Agriculture, Nutrition, and Forestry,
Henderson, KY.

The committee met, pursuant to notice, at 10 a.m., in the circuit courtroom, Henderson circuit, Hon. Mitch McConnell presiding.

Present: Senator McConnell.

STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM KENTUCKY

Senator McConnell. I want to thank all of you for coming out today to this field hearing of the Senate Agriculture Committee. Subsequent to my election in November 1984, two large problems were dropped in my lap, both of them we're still working on. One of them is trying to save the tobacco program in Kentucky, which is proving to be extremely difficult, and the other is the subject that we are here about today, and that is the question of the future of Big Rivers Electric Corp.

Many, many fingers have been pointed at Big Rivers over the past several months, as we all know, and I might at this point commend the Evansville Courier for, what I thought, was a rather outstanding series of articles about the history of the co-op and where we are at this particular juncture.

Articles have been written, investigations have been conducted. These investigations conducted by the U.S. General Accounting Office and the Inspector General for the U.S. Department of Agriculture, have today, vindicated the utility. At the close of my statement, I'd like to insert the findings of both those investigations.[1]

What we're struggling with today is an unnecessary powerplant and no foreseeable means to pay for it. It doesn't make much sense to debate the logic of building the Wilson plant—it's here. That decision was made using certain assumptions that didn't formalize. But Big Rivers did not build this plant alone. It was built with the approval and funding of the Rural Electrification Administration. So rather than allocate blame, it's time we face facts. We've got the plant, like it or not, and we've got to live with it until such time as it is sold or its power is sold.

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[1] See pp. 45–51 for the reports from the Department of Agriculture and the General Accounting Office.

To compound the problems facing Big Rivers, its two largest customers, National-Southwire and Alcan Aluminum are in severe financial trouble due to the large and sustained downturn in the aluminum market. From my standpoint, a long-term solution will be seriously jeopardized unless we can assure the viability of these two customers. Today, Big Rivers is unable to service its debt and this problem will only be compounded if the utility loses one or both of its largest customers. This industry not only provides substantial revenue to Big Rivers but it's vital to the local economy in terms of jobs and taxes as several of you will testify.

In January, when REA filed a foreclosure suit against Big Rivers, there was a question of how much longer the utility could survive. Well, it has survived thus far and it doesn't appear that the utility is presently poised to file bankruptcy or that REA is ready to pursue foreclosure. These two paths of action have been put on the back burner to offer more time for a solution to be worked out. That is why we're here today. To see what the principals are doing to ensure a long-term affordable energy supply to this area.

To hazard a guess, I would estimate that my office has met or talked with the parties in this matter more than 100 times in 1 year. Individual assessments of the situation have been different, if not conflicting. For my purposes, and for the needs of the Senate Oversight Committee, I believed it necessary to bring all the principals together to discuss where these negotiations are heading. Second, I believe a service will be rendered to the customers of this area to have this issue discussed in the open. A lot of conversations and negotiations have been conducted behind closed doors. That's not all bad, but the customers have a right to know how these negotiations are proceeding. That's why we're here today.

For those of you who are familiar with the players in this controversy, it's apparent that two of the principals are absent.

Both the U.S. Department of Agriculture Under Secretary for Small Community and Rural Development, Frank Naylor, and REA Administrator, Harold Hunter, were asked to testify. They won't be here today because the U.S. Justice Department advised against it. In a letter to me, the Assistant Attorney General stated the following:

> Because these problems are currently the subject of civil litigation, as well as sensitive settlement negotiations, the Department of Justice believes that it would be inappropriate for any Federal officials to testify on these matters at this time. Because loans totaling over $1 billion are at issue, this litigation is especially sensitive:

They said: "While I can assure you that the representatives of the United States are making every effort to find a satisfactory resolution to this difficult problem, any public discussion of our litigation strategy or position in negotiations at this stage would be counterproductive."

Let me say as someone who used to work in the Justice Department that that's a bunch of baloney. There is no good excuse for them not to be here. My experience in the past with this particular excuse is that you haul it out when you want to use it, and you ignore it when you don't. I want you to know that I don't appreciate the fact that REA isn't here today, and they have not heard the last of this.

While I don't agree with REA's decision to sit this one out, I'm certainly not surprised. The Department of Agriculture doesn't want to speak publicly, but that doesn't eliminate the need for public discussion, and that's what we're going to have without them. Their absence here today will only increase the pressure they'll get from me, and all the other interested parties, to negotiate instead of litigate. The foreclosure suit has given them a reason to keep quiet today. But they'll have lots of questions to answer as a result of this hearing, and I don't intend to let them off the hook.

Big Rivers' default was precipitated when its line of credit was yanked by REA. That action was particularly absurd since it was taken with the Wilson plant almost 99 percent complete. Big Rivers chose to complete the plant, and diverted debt service to pay contractors. REA foreclosed. REA then hatched a notion that, if Big Rivers merged with East Kentucky, everything would be solved. On that suggestion, Big Rivers and East Kentucky paid for a study by Bechtel and agreed to the so-called Bechtel merger. And what happened? The Government decided that maybe merger wasn't such a good idea after all. It was going to cost the Treasury $600 million. So they rejected the merger and retreated. But the foreclosure suit is still pending, with an overwhelmingly negative effect on Big Rivers' attempts to sell its power and find a way out of its credit crisis.

What I have before me is a statement for the record submitted by USDA.[1] No doubt it has been gone over with a fine-toothed comb lest some valuable bit of strategy be divulged. Nonetheless, it is a statement of the major lender and pertinent to the hearing record.

Your appearance here today shows the consumers of Big Rivers' power that you are willing to discuss a problem that we all wish would go away. Your attendance indicates that you're willing to make a good faith effort to tackle these problems. No useful purpose is served by a we against them attitude. We're going to compile a hearing record today which will speak for itself. We're going to hear what has been done and what hasn't been done to move toward a successful resolution of this problem.

I don't have a magic solution to the problems facing Big Rivers. Neither does anyone else. But we all know about the squeaky wheel theory. We all know, that left to their own devices, most of the bureaucrats in Washington would rather push this problem under the rug and hope someone else would inherit it. I hope this hearing will keep that from happening. I hope this hearing will focus attention on the issues, strengthen our hand at the negotiating table and move us toward the direction of a final resolution.

I am very pleased that all of you came out, and at this point we'll go to the witnesses, and the first witness today is Hon. William L. Newman, who is mayor of the city of Henderson.

Mayor Newman.

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[1] See p. 51 for the statement submitted by the USDA Rural Electrification Administration.

STATEMENT OF HON. WILLIAM L. NEWMAN, MAYOR, HENDERSON, KY

Mr. NEWMAN. I appreciated very much this morning, Senator McConnell, and Mrs. Walker, you coming here to hear some of our concerns, again, we totally concur that perhaps if the REA and Department of Agriculture had been here that maybe on a local basis that all of us working together, there is a solution.

My name is William Newman, I am the mayor of the city of Henderson. I welcome this opportunity to express my views on the serious problems facing this community brought about by Big Rivers' present financial distress.

Since becoming mayor in 1970, I have worked closely with all of our utilities to promote economic and industrial development. Early in my first term in office, the city of Henderson and Big Rivers Rural Electric began negotiations on the construction of a 350 megawatt generating station that would provide for a long-term electrical supply for the city of Henderson and also provide electrical energy for industrial development in Henderson and Henderson County. Because of the availability of power from these generating units, Anaconda Aluminum built a smelting plant in our county that was later sold to Atlantic Richfield Co., and is now owned by Alcan Aluminum.

The basic reason for this partnership began in 1970. Big Rivers was not in a position to finance the plant construction but needed energy capacity in order to attract Anaconda to Henderson County. We needed industrial expansion and job creation, and we had the bonding capacity to provide the funds for the powerplant construction. While we only needed a small portion of the power from such a plant, the amount of consumption of electrical energy by city customers was doubling every 7 years. The city was in a position at that time to ensure our citizens with low cost power for years to come.

Because of a change in the economic viability of the aluminum market, we have seen a decrease in production and employment at the Alcan facility. One of the factors affecting the competitiveness of the aluminum market is the cost of electrical energy and, likewise, the decrease in electrical consumption has adversely affected the price of electricity.

Big Rivers Electric Corp. has been a key economic component of the city of Henderson and Henderson County. This corporation is now providing employment for approximately 517 persons in Henderson County, and surrounding areas.

I applaud your efforts and that of your staff in working with Big Rivers management and the city to find a solution to the problems that now exist. The answer to Big Rivers' financial problems lies in the ability to sell future power produced at competitive rates. The answer is not foreclosure by the Rural Electric Administration and the Department of Agriculture. Such an action may appear to be responsible, but I submit it is irresponsible because REA is a partner in Big Rivers' activities. REA should act like a partner and not an adversary.

There is much more at stake in this question. Has there been any analysis done on the economic impact of closing Big Rivers as a corporation? If so, I have not been advised of the conclusions of such an analysis. Have the REA Administrators aggressively worked toward such a solution rather than working toward foreclosure? REA rejected a merger plan prepared for Big Rivers and East Kentucky Rural Electric Corp. Have they looked at other solutions to this problem? It appears that REA is determined to close the doors at Big Rivers.

The city of Henderson sold revenue bonds totaling $76 million in 1971 to finance construction of the city-owned powerplant on Green River from which Big Rivers was obligated to take and pay for all surplus power until the year 2003. As a result, customers of our city utility have been blessed with low electric rates and a dependable source of power for more than a decade. An aluminum smelter providing much needed jobs for this community was also part of the package. Big Rivers is now in trouble because of overestimated load projections and has no market for the power from its recently constructed D.B. Wilson station in Ohio County. It is not my purpose here to find fault or fix blame for Big Rivers' present difficulties. I do know, however, that many other electric utilities throughout the country overestimated their load projections for this decade. I also am not here to question the concern of the Rural Electrification Administration with Big Rivers' predicament. A default of over $1 billion in Government loans cannot be overlooked and must be dealt with. However, I do question Government action in filing a foreclosure suit in Federal court requesting sale of Big Rivers' assets at the courthouse door. A sensible solution cannot possibly result from this approach. The foreclosure suit merely compounds the very real economic danger to western Kentucky presented by Big Rivers' financial difficulties.

I am most distressed with the Government's present attitude toward the city-Big Rivers' contractual commitments. REA investigated and gave its prior approval to these commitments before issuance of bonds and construction of the city's station 2 powerplant. Now, like Pontius Pilate, the Justice Department and REA wash their hands of any obligation in connection with this project. The attitude of the Government, expressed to me and other city representatives at a meeting in Washington on March 25, 1985, was that REA recognized no responsibility for the survival of Big Rivers' commitments to buy surplus electric power from the city of Henderson in the event Big Rivers' demise or upon sale or disposition of its assets to another utility or utilities. The Government is also opposing our efforts to intervene in the foreclosure suit to protect the city's interest in this matter. This noncooperative bureaucratic attitude exposes the city to a possible default on its outstanding revenue bonds in the amount of $67,500,000 which must ultimately be primarily retired from the sale of surplus power to another utility or utilities. It should be noted that a market may well exist for the sale of the city of Henderson's station 2 power because the cost to amortize this plant is much less than that for the D.B. Wilson station. The Big Rivers-city of Henderson powerplant venture was built for approximately $200 per kilowatt-hour of capacity and we have benefited from this low construction cost in the payments made on the debt through the years. However, REA continues to ignore the city's peril in this matter. Any influence exerted by you or the Senate Agriculture Committee on REA and the Justice Department to recognize a need to cooperate with the city will be greatly appreciated.

In conclusion, I want to thank you for listening to my comments and your efforts to seek a long term solution to this very serious problem.

Senator **McConnell**. Thank you, Mr. Mayor, I certainly agree with you, foreclosure doesn't seem to solve any problem. When you came to Washington in March, you said Henderson's bond ratings were in jeopardy, has that changed since March?

Mr. **Newman**. No, sir.

Senator **McConnell**. You're still right where you were in March?

Mr. **Newman**. Yes, sir.

Senator **McConnell**. Big Rivers' contract with Henderson obligates the utility to take or pay for all surplus power until the year 2003. Do you know how much surplus power Big Rivers must buy every month, which it can't use?

Mr. **Newman**. From the city?

Senator **McConnell**. Yes.

Mr. **Newman**. I think our average is about 15 percent of the 350.

Senator **McConnell**. How much power does the city consume?

Mr. **Newman**. Well that is the—we base load with that, we have another generating system and we go up to around 80 megawatts in the summer season when we utilize most of our energy.

Senator **McConnell**. Thank you very much, Mr. Mayor, I appreciate your coming.

We'd like to call at this time, William Klausing, senior vice president, Irving Trust Co., New York, and Herbert F. Jacobs, vice president of Manufacturers Hanover Trust, also of New York. I understand you all are going to come up as a panel.

STATEMENT OF WILLIAM F. KLAUSING, SENIOR VICE PRESIDENT, IRVING TRUST CO., NEW YORK, NY

Mr. **Klausing**. Good morning, Senator McConnell. My name is William Klausing; I am senior vice president in charge of the Public Utilities Division of Irving Trust Co. in New York City.[1]

In my testimony today I would like to address several matters: First, what is Irving Trust's interest in this matter? And second, what is being done and what else can be done with respect to Big Rivers and the consumers it serves in Kentucky?

Irving has long been one of the Nation's leading banks in lending to the public utility industry. While we have had a long history of lending to investor-owned utilities, as a private institution we have not been able to compete with the Government in lending to the rural electric system. We, therefore, have been supportive of the administration in encouraging rural electric cooperatives to seek access to private banking and capital markets.

One such instance involves Big Rivers Electric Corp., Ohio County, KY, issued pollution control bonds to provide funds to pay for pollution control equipment to be used by Big Rivers in connection with its Wilson powerplant. Because Ohio County issued the bonds, they were tax exempt. If the tax-exempt financing had not been made available the scrubbers being financed would have been built with REA funds which had been set aside for this purpose. The funds from the bonds merely replaced REA funds, thus lowering the debt cost to Big Rivers.

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[1] See p. 52 for the prepared statement of Mr. Klausing.

The ability to raise money from such bonds, and the marketability of those instruments, turns, obviously, on the confidence that investors have that the bonds' principal and interest payments will be met. In this case, institutional investors were not familiar with Ohio County or Big Rivers. So in 1983, Irving Trust increased this investor confidence by issuing a standby letter of credit to assure payment of the bonds principal and interest. Irving receives a fee of ⅝ths of 1 percent is, of course, much lower than one would expect if you looked at the financial statements of either Big Rivers or Ohio County. But we entered the deal knowing that the plant was nearly complete, REA funded, and that there had never been a bankruptcy by a rural electric cooperative.

Let me briefly turn to the steps we have taken since the Government initiated its foreclosure action. Irving Trust has undertaken to open lines of communication among the business people and policymakers at the Government, Big Rivers, and the banks.

A working group was established, which included bankers experienced in financing, loan work-outs, and restructuring, representatives of the U.S. Department of Agriculture, of which REA is a part, and officials of Big Rivers, who understand the problems that they face.

The working group has been examining the economics of Big Rivers and of the industry. Among the issues being explored are: Off-system power sales, transmission problems, management of the company's reliance on the aluminum smelters, expense controls, existing coal contracts, sale of the Wilson plant—in whole or in part—sale of other Big Rivers generating plants, real estate sales, and possible mergers.

The banks and the Government agreed to share the costs of retaining one of the leading consulting firms in the energy field, ICF, to examine Big Rivers. Big Rivers, as part of its effort to solve its problems, has retained a Pittsburgh-based marketing/consulting firm that specializes in energy matters to assist in the effort to locate and negotiate off-system power sales. Negotiations have already commenced with several utilities, and proposals are expected from others. The point is that the working group is considering a spectrum of alternatives, and we all understand that the problems that face Big Rivers will not be solved this week, this month, or even this year. The goal is to assure the long-term economic viability of the Big Rivers system.

This may well involve short-term, off-system power sales to provide revenue to enable Big Rivers to survive until such time as the demand for electricity in western Kentucky has caught up with the supply. We know this may be 5, 7, or even 10 years. It may be that the answer is even longer term power sales that would enable Big Rivers to survive and continue to serve the people of Kentucky even if the demand locally does not increase. The key, as we see it, is to examine each and every alternative, and that is precisely what we are doing.

Where do we go from here? What else can and should be done? It seems to me we have some of the answers, but not all of them. It, therefore, is critical that the working group continue its efforts and that Big Rivers not be diverted from the task. The Government, and the banks, including Irving, have an enormous financial stake in the success of Big Rivers. While the total bank exposure is about $150 million, the Government position is approximately $1.1 billion. That gives us all an incentive to try to find the best way to make Big Rivers viable and economically successful.

We also believe that it is important for Congress to continue to oversee Federal policies which affect entities such as Big Rivers. We know that Congress recognizes the importance of the Rural Electrification Administration and the system. The actions of Congress to ensure continued funding of REA demonstrates a continued commitment to the system. As you might imagine, the uncertainty posed by a bankruptcy and foreclosure proceedings has significantly limited the cooperatives' access to credit markets. However, we believe that at Big Rivers things are now on the right track and headed in the right direction. We think we are playing an active and a constructive role in coming up with viable economic solutions to Big Rivers' problems.

Thank you very much.

Senator McCONNELL. Thank you, Mr. Klausing. I think what we'll do is take Mr. Jacobs' statement, and then I will have some questions for both of you. Mr. Jacobs.

STATEMENT OF HERBERT F. JACOBS, VICE PRESIDENT, MANUFACTURERS HANOVER TRUST CO., NEW YORK, NY

Mr. JACOBS. Good morning, Senator. My name is Herbert F. Jacobs, vice president of Manufacturers Hanover Trust Co. I also serve as chairman of the working committee, a committee formed of representatives both from Big Rivers' creditors and Big Rivers' management.

Big Rivers' problems have been well detailed in the press for some time, but allow me to bring my own views of the situation to your attention.

We have an electric utility co-op, Big Rivers, with a 440 megawatt plant, Wilson, which is largely surplus to its service territory. A solution that focuses solely on the rate payers is not feasible. Big Rivers recognizes this, the creditors recognize this, and the Kentucky Public Service Commission recognizes this. However, a solution that results in denying repayment of just debts related to financing Wilson is just as unacceptable.

Clearly a middle ground must be found. To that end, the working committee has been working to achieve alternatives that satisfy the rights of all involved with Big Rivers.

One possible approach is to sell Big Rivers' surplus power to purchasers outside its service area. One sale for 54 megawatts has been consummated, another for up to 108 megawatts is awaiting REA approval. Letters of intent for the remainder of the surplus power have been received by Big Rivers and if these letters are turned into contracts, Big Rivers' ability to pay its debts will be significantly enhanced. A merger or combination with another utility is also a possibility and cannot be ruled out. Sale of Wilson in part or in whole is another alternative still under study.

I sincerely believe that an economic solution, fair to all concerned, is possible and preferable to bankruptcy or to foreclosure. What is needed is time. With time, the value of Big Rivers power, surplus to the region, but not surplus to buyers outside the region, can be maximized, thereby allowing the free market to solve much, if not all, of Big Rivers' problems.

Thank you, Senator, for the opportunity to present my views.

Senator McCONNELL. Thank you, Mr. Jacobs. How much does Big Rivers owe Manufacturers Hanover?

Mr. JACOBS. Well, approximately $83 million, but I wouldn't necessarily use the term "owe" as such because we, as Irving, have put a letter of credit on the financing, and so the debt is actually held by institutions and individuals outside of Manufacturers Hanover. We've only confirmed the obligation of Big Rivers to repay that debt.

Senator McCONNELL. You've recently restructured the loan, haven't you?

Mr. JACOBS. That is correct. In fact initially Big Rivers was paying approximately 7¼ percent out of the restructuring, we managed to bring the cost to Big Rivers down to approximately 5.875 percent.

Senator McCONNELL. You mentioned the working committee, how often does it meet?

Mr. JACOBS. It's not a regularly scheduled event every week or every other week or anything like that, it meets as the needs are dictated by events surrounding it, but I would estimate we must have met over 25 or 30 times since we were formed in July of this year.

Senator McCONNELL. You're meeting again on the 22d I understand, is that right?

Mr. JACOBS. Yes, we are coming down to a meeting with Judge Johnstone who's holding a hearing on the subject of Big Rivers.

Senator McCONNELL. Have the meetings, by and large, been productive?

Mr. JACOBS. I think that they have improved over time, and I think that's really a function, Senator, of the efforts made by Big Rivers to try and sell power.

If I may diverge a little bit from that question for a moment, in any kind of work-out problem you have to ask yourself the question: Is the entity that's involved and the commodity that it's involved with gaining in value or losing in value? Because that's a primary question for any creditor. We're talking here about surplus power, which is not subject to style nor technological change nor spoilage. In fact there is, I think, a very good argument that that power can increase in value.

The other ingredient of a successful work-out is management. Does it have the ability to solve the problem, and does it have the willingness to solve the problem? My experience, Senator, over the 15 years I've been in commercial banking, there are companies that have the will to rise above their problems and solve them, and there are some companies whose management is not willing to take that extra step. I do not think the latter's the case with Big Rivers. I think they have both the will and the commitment to solve their problem, and I think the board does too. I think we've seen that in recent months in respect to their efforts to try and sell power.

Last week we received—I shouldn't say "we," but Big Rivers has received a letter of intent from one utility for a substantial amount of its power, 400 megawatts, at prices that would go a substantial way to paying interest on its debt.

So we have been meeting, I have seen progress, I think the progress is a result of what's been forthcoming in recent weeks, and as long as one sees that more money is coming in to solve the problem it tends to spark a little bit of cooperative spirit among the people that are at the meeting.

Senator McCONNELL. How much of a problem is the foreclosure suit in the effort either to sell the power or sell part of the system? How much of an inhibition is that?

Mr. JACOBS. I'd say that it would be easier to sell the power without the foreclosure suit, but I would be dishonest with you, Senator, to say that it would stop the sale of power because we have received these letters of intent through some fairly aggressive marketing efforts on the part of Big Rivers and its consultants. But it certainly would be easier to sell power if you didn't have a cloud over the company in the form of a foreclosure suit. No doubt about it.

Senator McCONNELL. Then it's a problem, but not much of a problem.

Mr. JACOBS. Well, I don't know if the prices that we've received incorporate a factor of that foreclosure suit. Some of the prices that we have received from some buyers have been on the low side, and I suspect that that represents a bit of an opportunistic attitude on the part of those buyers. If that suit was removed we might get a little bit of a bidding war going, upping the value of the assets. It's certainly easier to maximize the value of assets outside of a law suit than with a law suit going on. But what that difference exactly would be, I can't say, nor should I think anyone else could say exactly.

Senator McCONNELL. It just occurs to me that there might be some feeling you could pick things up a good deal cheaper a little way down the road by just waiting.

Mr. JACOBS. I think that that's true. I think that time will enhance the value of these assets. It's not unlike a situation where an investor goes out and buys shares in a certain corporation and finds that the market has not been on the same side as the investors thinking. Does the investor immediately sell, or is the investor convinced that the investment that he has is indeed a good one? And over time perhaps it is. And that is what we're saying here, is that the assets of the Wilson powerplant have a value today that will perhaps be enhanced with time, because we think the growing demand for power will eventually result in prices that will allow full repayment of the debt.

Senator McCONNELL. Just for the sake of discussion. Put yourself in the shoes of REA for a moment, looking at it from their point of view, what purpose does the foreclosure suit serve?

Mr. **Jacobs**. Well, I think I might want to dodge that question, Senator.

Senator **McConnell**. I wish you wouldn't.

Mr. **Jacobs**. The reason I say that is that it's difficult for me to speak on behalf of REA, we have different interests and different attitudes toward the situation, but I think that they feel that this is a stick that is useful. I'm not saying that I share that view.

Senator **McConnell**. Is it an appropriate stick if it inhibits the effort to sell part of the system or the surplus power?

Mr. **Jacobs**. Well I think that's a question better put to Mr. Hunter.

Senator **McConnell**. I've done that.

Mr. **Jacobs**. But I'm arguing, Senator, that the likelihood of the value of bids being received, being increased, is going to be greater if the suits were removed than if they were in place. The Justice Department, the Department of Agriculture, and REA have their reasons, but I think they best speak for themselves than I speak for them. I get in enough trouble speaking for the bank, Senator, without speaking on behalf of those organizations.

Mr. **Klausing**. Senator, if I could make a comment?

Senator **McConnell**. Please do.

Mr. **Klausing**. Litigation tends to make long-term contracts difficult, whether these long-term contracts be for the sale of power or for the sale of a plant. Litigation does not affect things in a short range as much as it does in the long range, and I think that's where we could see people perhaps looking for a fire sale rather than heavy negotiations.

Senator **McConnell**. Since the Justice Department dismissed the merger proposal, at least as originally envisioned by the Bechtel study, are either of you aware of any attempt by REA to pursue another merger option or to restructure the Bechtel proposal?

Mr. **Jacobs**. No, I'm not.

Mr. **Klausing**. I'm not aware of any.

Senator **McConnell**. Mr. Klausing, you indicated in your statement that the working group should be allowed to continue its efforts and that Big Rivers not be diverted from that task. What diversions are you talking about?

Mr. **Klausing**. Well, I feel litigation is a diversion, and litigation for the early months of this year were diverting all of us from the task of trying to find an economic solution. I believe that the working committee and the dialog among the various lenders and the company created by the working committee has been helpful to start us down the path of finding the economic solution in the private sector.

Senator **McConnell**. As you're aware, as we're all aware, Big Rivers is not the only rural cooperative having financial problems.

Mr. **Klausing**. We're aware.

Senator **McConnell**. How much of a precedent is what happens to Big Rivers for the balance of the system and the other co-ops that are in trouble?

Mr. **Klausing**. Well, I think it would have to be a precedent just because it's there and because the other co-ops who are having some financial difficulty are there. In trying to find a solution you obviously are going to look to see what other solutions have been found. As I've mentioned, we are working and trying to find an economic and a private sector solution. We don't want to see a litigation and a court solution to the problem if we can find one on our own.

Senator McCONNELL. One of the things the working group is looking at, you said, was the Big Rivers reliance on the aluminum industry. Do you have any particular suggestions for that dilemma?

Mr. KLAUSING. Well, as bankers we finance many industries all over the world. We are familiar with the aluminum industry and in financing it and with some of the problems that the aluminum industry is currently having. I don't think I can make any comments other than the aluminum industry and the components of it must find the most economical and operate the most efficient manner to compete worldwide. They have advantages here in Kentucky of location, and transportation which they have to use in their marketing efforts for survival. I can't make any comments other than that.

Senator McCONNELL. Does the foreclosure suit make it more difficult for your bonds to be marketed?

Mr. KLAUSING. I think it's one of the factors that makes it more difficult for the bonds to be marketed. The bonds have been remarketed several times as holders of the bonds decided they no longer wanted to hold the bonds. As to exactly what factors caused them to make that decision undoubtedly litigation is a factor that would make people decide to seek other investments.

Senator McCONNELL. When is the ICF study going to be complete?

Mr. KLAUSING. Well that's in a—several phases. We are completing the second phase, moving to the third phase. I don't have the exact date—perhaps Herb, do you have the date?

Mr. JACOBS. Well we're expecting an interim report in written fashion on or about November 21, Senator. Part of the decision of when to finalize ICF's efforts is somewhat dependent on what happens with the number of the letters of intent and the evaluation that would take place of those letters of intent.

Unfortunately, surplus power is not as easy to sell as it would be say a aircraft, for several reasons. One reason is that some of the buyers are not located adjacent to the utility, which means that the power has to be wheeled, a term used by people in the industry to indicate transporting the power from one area to another. And that necessarily involves another party to the contract, not only is the utility in another State involved, but there is a utility in between, and because of the long drawn out nature of those contractual discussions ICF may be on board for a number of months further into this problem until we finally activate and finalize these letters of intent into contracts.

Senator McCONNELL. One of those, of course, you mentioned was the 400-megawatt selloff?

Mr. JACOBS. That's correct.

Senator McCONNELL. So you don't have any idea when we might know whether that sale could be consummated?

Mr. JACOBS. No, I think it's difficult to predict the timing of that because there's still going to be discussions about a various number of issues, including the firming of power and so forth, but I would like to believe that if the buyers are sincere, we certainly know that Big Rivers is sincere in trying to sell the power, that a sale could be consummated in a number of months. But even having said that, Senator, it should be realized that a number of these cases the utilities that are looking to buy power already are buying power from other suppliers indigenous to their own State and that there's usually a 2- or 3-year shutoff notice before they can change over. So there's going to be a gap in between that, however, we're hopeful that some interim sales could take place until the time the final contract goes into effect.

Senator McCONNELL. Would that particular sale be the light at the end of the tunnel?

Mr. JACOBS. It would be a lot of the light, I don't know if it would be "the light." It might not get us completely there, but we are talking about substantial amounts of money that would be available to pay interest.

I think what the creditors have basically said here, Senator, is this, that if we can get to the point where we can satisfy the interest obligations on the debt the creditors would take the risk as to the principal being repaid out of the renegotiation of these present power sales under discussion which usually run for 10 or 15 years, some might run longer, but there are some sales either on the table, or that have been executed that expire around 1995 or the year 2000 and that out of those renegotiated sales we should have sufficient revenues to pay the principal, as well as the interest. I think that's our contribution to part of this problem.

Senator McCONNELL. I'll ask the question one more time, the 400-megawatt sale would be a very significant item?

Mr. JACOBS. It would indeed.

Senator McCONNELL. And that might well——

Mr. JACOBS. It would have a substantial impact on Big Rivers' ability to pay interest to the Federal Government, a strong concern of the Federal Government which you well can imagine.

Senator McCONNELL. At the risk of rehashing it, once again I want to make sure I understand this, that from your point of view the foreclosure suit serves no purpose for any of the parties except REA, and you're not quite certain what purpose it serves for them?

Mr. JACOBS. I'm certainly not equipped to speak for REA, but it does not serve our purpose as unsecured lenders I don't think, and Big Rivers is here to testify, you could ask them directly, Senator, but I don't think that Big Rivers is particularly encouraged by that suit either.

Senator McCONNELL. I'm sure they aren't. Do either of you have anything else to add?

Mr. KLAUSING. I do not.

Mr. JACOBS. Nor do I.

Senator McCONNELL. I want to thank you both very much for coming, I appreciate it.

I would like to call now W.H. Thorpe, the general manager of Big Rivers. I understand that Mr. Thorpe is going to be accompanied by Morton Holbrook and Scott Reed, is that correct?

Mr. THORPE. Yes, sir. Thank you.

STATEMENT OF WILLIAM H. THORPE, GENERAL MANAGER, BIG RIVERS ELECTRIC CORP., ACCOMPANIED BY MORTON HOLBROOK AND SCOTT REED

Mr. THORPE. Good morning, Mr. Chairman.

On behalf of Big Rivers Electric Corp.'s board of directors, our management, our 825 employees, and our 73,000 consumers here in western Kentucky, welcome to Henderson. We at Big Rivers sincerely appreciate your interest in our situation and thank you for being here today.

Pursuant to your request I have previously submitted my testimony, and we have made copies available to those interested parties here today.[1] Within my testimony I have briefly described the conditions which led to our problems such as: First, an unprecedented decline in the growth of electricity, locally and nationally; second, unanticipated and continued low, worldwide aluminum prices; and third, the long time necessary to acquire a powerplant site, and construct a generating plant which requires the matching of supply and demand over approximately 8 years in the future.

We also point out the vigorous efforts we have made in long- and short-term power sales to other utilities. We have also offered to sell the Wilson plant, or the entire Big Rivers system. We have made significant reductions in power cost to our consumers, primarily resulting from renegotiations on some major coal contracts.

Again, as pointed out in my testimony, we believe that the sales of power to other utilities will be the answer to our problems, and with the help of those that are concerned and affected we can and will succeed.

I have just one comment on my testimony, Senator, on page 7, I stated that we were renegotiating some major coal contracts and hope to have those consummated by the time of this hearing. I'm happy to report that we finalized the last of those on November 1, which gave us significant reductions in our coal costs. I have no changes to my testimony as submitted, therefore, I will try to answer any questions you may have.

Senator MCCONNELL. Thank you, Mr. Thorpe. I am particularly interested in your relationship with REA. Specifically I am interested in the following: In its study the General Accounting Office concluded that REA's actions appeared to reflect its overall policy that borrowers are responsible for the operation of their power systems, is it your perception that REA's actions have been in line with this policy?

Mr. THORPE. Well, yes, sir, they have constantly advised us, Senator, of what we can do and what we can't do. Even on loan funds there is just volumes and volumes of information that has to be submitted to the REA prior to approval of those loan funds. I think the—up until the termination of our loan funds in November 1984, we experienced no difficulties with them, and at the time they terminated those loan funds our powerplant was 99 percent complete, and as a result of that termination we had to take the general funds that we had to pay REA—I mean to pay the contractors for the finishing of the work to get the plant online and running so we could attempt to make sales from that plant.

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[1] See p. 55 for the prepared statement of Mr. Thorpe.

When they cut off those loan funds why naturally we did not have the necessary funds to pay our debt payment to REA, and pay the contractors, therefore, the foreclosure followed immediately. But let me point out, Senator, had they not filed, or had they not cut off our loan funds we would have been able to make our debt service to REA and would still be doing so due to the fact the Wilson plant is still not commercial, and probably will not be until October 1986, due to some difficulties that we're having with our scrubber system, and the engineers will not give you a certificate to commercialize until those problems are worked out.

I hope I answered your question.

Senator McConnell. Well, I suppose it's safe to say your relationship with REA was strained at that time, has it gotten any better in the interim?

Mr. Thorpe. It has gotten better, Senator, since about March or April of this year when the working committee was formed with the banks, and finally the Federal Government appointed a member to this working committee, and we have been looking at the power sales, meeting frequently as Mr. Jacobs testified earlier.

Senator McConnell. Have they been an active part of helping you seek out opportunities for power sales and/or system sales?

Mr. Thorpe. No, sir, they have met as a—or they have a representative from the Federal Government that has met with us, but they have never made any suggestions on who we should go to. We always report to them on what we're doing.

Senator McConnell. Do they have to approve the power sales?

Mr. Thorpe. Yes, sir.

Senator McConnell. But they don't play any role in the negotiating of the sales?

Mr. Thorpe. No, sir.

Senator McConnell. With regard to the merger, when was Big Rivers approached with the idea of a possible merger with East Kentucky?

Mr. Thorpe. I was called to Washington on November 13, 1984 to meet with the assistant administrator, Jack VanMark, and I was told on that day that they wanted us to merge with East Kentucky, and they wanted us to do it by December 27, 1984, which was 6 weeks from that date.

Senator McConnell. Did they lay out the terms and conditions for you?

Mr. Thorpe. Well they handed me about four or five sheets of paper from a legal pad that an accountant on the staff had worked up with different scenarios on what the rate increase would be necessary if we had, a leverage lease, what it would be if we didn't have a leverage lease. He said he'd spent 3 days on it and had made a comprehensive study and it proved feasible that we merge with East Kentucky. I told him I didn't think that could be done in Kentucky, and that we would have to have a study made first, I was sure, before our board would approve it to make sure that it was economically feasible and what effect it would have on our 73,000 consumers in western Kentucky. They said we did not have time to do that, that they wanted the merger put into effect and do it by December 27 so the leverage lease could be put into effect for 1984. Of course we came back, we got board approval to make the study.

Senator **McConnell**. The Bechtel study?

Mr. **Thorpe**. Yes, the Bechtel study, and the study was started some time in December.

Senator **McConnell**. When the Government rejected the Bechtel merger proposal, I think it indicated to you that you'd receive a written response to the memorandum of understanding. Did you ever receive such a response?

Mr. **Thorpe**. The only response that we received was from the Justice Department telling us that the merger study was rejected.

Senator **McConnell**. And there were no suggestions or possible variations of that or any kind of negotiation using that as a starting point? Nothing?

Mr. **Thorpe**. Nothing. No, sir; the only thing we received after that was some time in August. A letter was written to the general counsel for East Kentucky, which I got a carbon copy of, it was from the Administrator, Harold Hunter, advising that we should keep our options open on the memorandum of understanding and they would be back to us some time around the middle of September.

Senator **McConnell**. That hasn't happened, has it?

Mr. **Thorpe**. No, sir.

Senator **McConnell**. Do you believe the merger approach is dead?

Mr. **Thorpe**. Well I wouldn't necessarily say it's dead, Senator, but it would make—I think the Federal Government would have to accept some of the terms and conditions there, one being of course the preferred stock that was necessary in the amount of, somewhere around $600 million. But even with the merger you are talking about a substantial rate increase to the Big Rivers consumers.

Senator **McConnell**. So as far as you can tell there are no further discussions among any of the parties about the merger proposal?

Mr. **Thorpe**. No, sir; I talk to Don Norris from East Kentucky frequently and he's like I am he's holding his options available but we don't know what those options are at this point.

Senator **McConnell**. Anything else you want to say on the merger issue?

Mr. **Thorpe**. No, sir.

Senator **McConnell**. Moving to sales; the sales which you have made and those which you hope to consummate, are those off the present system, are they from Wilson, or from both?

Mr. **Thorpe**. From both, sir. We still have approximately 200 megawatts of excess capacity in the present system, present system being exclusive of the Wilson station. We are offering that 200 megawatts in addition to the 400 megawatts from the Wilson station, and we have also offered it on a blended basis trying to in the present maybe sell 200 megawatts from the existing system and 200 megawatts from the Wilson station with a blended cost between the two, but the 200 megawatts from the existing system would be for a shorter period of time, maybe 10 years or up to 20 years on 100 megawatts of it. Doing that to try to hold down the rates in the earlier years to prevent rate shock, if you will, to whoever is buying the electricity from us.

Senator McCONNELL. Do you have under active discussion enough sales to see your way out of this dilemma? Essentially the same question I asked the two witnesses before you.

Mr. THORPE. Senator, at the prices that we're offering it today, particularly on the blended price, if we sold 400 megawatts for 35 years let's say, 200 megawatts from the Wilson station and 200 megawatts from the existing system, we would still have 200 megawatts from the Wilson station, that's the high cost demand, so in order to see our way out it completely we would have to sell 400 megawatts from the Wilson station at today's cost of that Wilson station, which is approximately $17 a kilowatt. I don't see that happening in the near future. But we feel that if we can make some sales, particularly on the blended rate, then in the early 1990's, according to the best information that we have available, there is going to be a demand for electricity and we think that we will be able to sell it at a even—possibly a cost higher than today's cost at the Wilson plant. So it's going to take time to solve the problem. We're not going to be able to sell the Wilson plant today at the Wilson plant cost, but we feel that if we can get some short-term sales on it that eventually we can do that.

Senator McCONNELL. Why did you wait until relatively recently to engage in a really aggressive effort to sell power?

Mr. THORPE. Senator, it hasn't come about just recently; it's been publicized recently.

Senator McCONNELL. Well, so how long have you been in a really aggressive effort to——

Mr. THORPE. Two and a half years.

Senator McCONNELL. Two and a half years. And how are you doing that?

Mr. THORPE. Well, we started off doing it ourselves. We had our own team at Big Rivers that was constantly calling on utilities throughout the eastern part of the United States. We worked on one in Texas for almost a year, and it fell apart at the very last minute. In fact it fell apart immediately when the Federal Government filed the foreclosure suit on us. Now I can't say that it fell apart because of the foreclosure suit, but it was quite a coincidence. In addition to using our own team, we've hired a consulting firm out of Pittsburgh, Russell, Rea & Zappalla, who are trying to sell the plant on a commission just like you were trying to sell real estate. If they don't sell the plant satisfactory to our terms and conditions——

Senator McCONNELL. When did that contract——

Mr. THORPE. That was April 12, this year.

Senator McCONNELL. That's what I was referring to when I asked you.

Mr. THORPE. Yes, sir; but prior to that time, Senator, we were making vigorous efforts throughout the United States—the eastern part of the United States in trying to sell the power, but we were doing it with our own team, and we had three people on that team.

Senator McCONNELL. Going back to power a minute, tell me again what is the current amount of surplus power that you have?

Mr. **Thorpe**. We have approximately 600 megawatts today, 400 megawatts from the Wilson station, and approximately 200 megawatts from the existing system. The 400 megawatts could be sold for 35 years, the 200 megawatts, we could sell 200 megawatts for approximately 10 years, and 100 megawatts for another 10 years.

Mr. **Reed**. Senator?

Senator **McConnell**. Yes.

Mr. **Reed**. My name is Scott Reed, I'm manager of engineering at Big Rivers. I'd like to, if I might, make some comments in regard to Mr. Thorpe's recitation of those numbers.

The availability of that amount of power, the amount of power that he mentioned as being available for sale would hinge on a couple of things, No. 1, we have an offer from an out-of-State utility on the availability of reserve generating capacity. If we sold that much capacity we would have to buy some reserve capacity to back up that amount of sales. We would not have the ability to sell 600 megawatts of capacity from within our own system as it exists today without purchasing some standby reserve capacity from others.

Senator **McConnell**. That would be a nice problem.

Mr. **Reed**. It would be a much nicer problem than the one we have, yes, sir.

Mr. **Thorpe**. But we've been able to find a utility company, Senator, that has been willing to do that if we can put a contract together in the very near future.

Senator **McConnell**. So what is the maximum amount of power that you can wheel out for sale?

Mr. **Reed**. Well the maximum amount that we could actually wheel out of the system for sale today, if we're wheeling it south is about 650 megawatts. If we're wheeling it north it's about 550 megawatts. If we're wheeling both south and north simultaneously the total would probably be around 600 megawatts.

Senator **McConnell**. Explain to me why it's different wheeling it north and wheeling it south?

Mr. **Reed**. Because of the capability of our interconnections and the power flows that occur on the system when you're exporting power. We just—we have a higher capacity to go south than we do north.

Senator **McConnell**. If all the contracts you're currently negotiating were brought to fruition how much excess power would remain?

Mr. **Thorpe**. We wouldn't have any.

Mr. **Reed**. I don't believe we would have any.

Mr. **Thorpe**. In fact the contracts—the letters of intent that we have, and the possibility of sales, if we consummate them all, we'd have to build an additional powerplant. So, you know, they're all just possibilities, Senator, we would not of course oversell our system is what I'm trying to say.

Senator **McConnell**. Shifting to another subject for a minute, what action, if any, prompted the Government to inform Big Rivers directors of the statute holding directors personally liable for the debt?

Mr. HOLBROOK. Senator, I don't believe the REA directly advised the directors of that statute. REA did advise Wabash Valley of that statute, indeed sent a letter to the directors and to the officers of that cooperative. We saw about this in the press and immediately contacted the REA to see if the REA contended that that statute applied alike to Big Rivers, and were then advised that that was the Government's position, that it did not apply to Big Rivers.

Senator MCCONNELL. They have given your directors a waiver until January 1986, is that right?

Mr. HOLBROOK. That is correct, sir.

Senator MCCONNELL. Has the Government lately made any movement toward foreclosure?

Mr. HOLBROOK. The action has been in a state of suspended animation I guess you would say. There are a great many motions pending. The Government has not pressed for a hearing on its motions, and most of the other movants have been equally quiet.

Senator MCCONNELL. So with the waiver granted and with the no pending motions in the foreclosure suit it's your judgment, Mr. Holbrook, that they are simply choosing to hold this—to hold it over your head to get your attention if that needed to be done?

Mr. HOLBROOK. It is, sir, that is my opinion.

Senator MCCONNELL. Is it working?

Mr. HOLBROOK. Yes, I think it is, in a sense that we are moving, as these gentlemen have told you, and as the gentlemen from the bank have told you. I don't know of anything that Big Rivers is doing because of that suit that it wouldn't be doing better without the suit. So in that sense I would say that it is not serving any useful function.

Senator MCCONNELL. So in your judgment it would be just as great a sense of urgency without the foreclosure action as with?

Mr. HOLBROOK. Indeed.

Senator MCCONNELL. Moving to your two principal users for a minute, how much power do Alcan and National-Southwire consume each year?

Mr. THORPE. Approximately 70 percent.

Senator MCCONNELL. Translate that into dollars for us.

Mr. THORPE. National-Southwire pays approximately $8 million a month, and I think Alcan is approximately $7 million a month, $15 million total between the two. It should be about $160 million a year I believe.

Senator MCCONNELL. I'm sorry, say that again.

Mr. THORPE. I think it is approximately $160 million a year between the two.

Senator MCCONNELL. Recognizing that Alcan and National-Southwire consume 70 to 75 percent of your power, and noting their precarious financial situation, the Public Service Commission in its May 6 order suggested that the parties attempt to negotiate a contract for a rate structure which links the demand charge paid by the aluminum companies to the market price of aluminum ingots. I understand that Big Rivers tried to negotiate such a rate with the aluminum companies. Why didn't it work, and would you be willing to try again?

Mr. THORPE. Yes, sir; let me answer your first question. In the order from the Public Service Commission, as we understood it, they were referring to the so-called Australian theory, or Australian plan.

Senator McCONNELL. You want to explain that to everybody, including me?

Mr. THORPE. Well, it was a plan whereby the Australian Government was backing the aluminum industry and it set up what was called a banking system, if you will. When the price of aluminum got below—or when the price of electricity—I'm sorry—when the price of aluminum got low they would reduce the price of electricity tied in to some scale based on the price of electricity and aluminum. If there was not enough money coming from the aluminum company to pay the electrical bill it came from the banking system which was backed, as we understand, by the State. The order that we got from the Public Service Commission was referring to the same theory, if you will, and that we would set up a system with the aluminum industry here that if we were selling them electricity at 22¢, or 22 mills a kilowatt hour, we couldn't pay our bills, so there would have to be a banking system set up that we would get paid from that banking system. Alcan made that proposal to us in July of this year and wanted to put it into effect in July of this year that we sell to them for 22 mills, do it on a trial basis running through June 30, 1987, and if there was a short-fall that they would sign notes for us, we would get a line of credit from a bank, if you will, that they would sign those notes and stand good for it, and as we needed the money each month we would draw down the amount between what our cost was and what they were actually paying us. If the price of aluminum went up, then the price of electricity would go up, and eventually even go up higher than what our consumers would be paying in order to pay back the bank, if you will. And then at the end of June 1987 if there was a deficit Alcan would pay off the entire debt, including interest on that debt. We made that proposal to National-Southwire and they said that it was not acceptable to them and in fact if we entered into it with Alcan they would use whatever legal means available to stop us from doing so because we didn't need to incur any additional debt.

Senator McCONNELL. What was REA's reaction to a variable rate for the aluminum industry?

Mr. THORPE. Well I don't think it has been presented to REA, Senator, to my—I remember we talked to REA about giving a frozen rate to the aluminum industry back in August of last year. At that time National-Southwire was agreeing to enter into a 10 year contract with us guaranteed by the parent companies if we would freeze their rate at $7 a kW, as opposed to what they're paying today, which is $6.25, but that rate would have been about 29 mills to them which last year, August of last year they were agreeing to do that. But today they are asking for 22 mills.

Senator McCONNELL. Did Big Rivers object to NSA's rate reduction request with the PSC?

Mr. THORPE. Yes, sir.

Senator McCONNELL. How much would you lose if that rate request reduction were entered?

Mr. THORPE. If it was for NSA only, if we did not have to reduce Alcan's rate likewise, it would be approximately $16 to $17 million a year. If we have to apply it to Alcan and to National-Southwire it's approximately $35 million a year.

Senator McConnell. NSA has also threatened to close its plant, what impact would closure of NSA have on Big Rivers customers' rates and your ability to operate?

Mr. Thorpe. It would be very devastating, Senator. We are already in a financial crunch as you very well know. We are not able to pay our debts to the Federal Government. If they close the plant you're talking about another $85 to $90 million revenue a year. If—more than—we could not get the excess power out of our system because of the restraints that Mr. Reed spoke of earlier, we only have capacity to get out 600 to 650 megawatts——

Senator McConnell. Let me interrupt. With the optimism that you now have that you can sell off some of the power, might it not have been a wiser course of action to work with the principal users to keep them in business?

Mr. Thorpe. Well, Senator, it's just a matter of—unless someone else helps us, if we give them a rate reduction that's necessary to keep them in business it's a matter of about 6 months at the longest that we can pay our bills. I'm not talking about, you know, excluding——

Senator McConnell. Is that true even if some of these sales come to fruition that we've been talking about?

Mr. Thorpe. No, sir; if we can make the sales we might be able to keep the doors open longer, but under today's scenario if we were to grant a 22 mill reduction to National-Southwire, National-Southwire only, it would be about November 1986 before we would be in a position that we would not be able to pay our bills.

Senator McConnell. Let's change the facts. Let's assume that the power sales currently envisioned are consummated, then what?

Mr. Thorpe. Well we could give a reduction to National-Southwire and to Alcan, but we would not be able to pay our creditors, the Federal Government and the banks.

Senator McConnell. But if they go belly-up you're largely finished anyway, aren't you?

Mr. Thorpe. The problem is even worse, yes, sir. So, you know, the problem that we have is not only a problem with the Wilson plant and paying the Federal Government, but out of the existing system devising a rate that can keep the aluminum industries in business. We have no lines of credit. The only revenue that we have is the revenue that we derive from our consumers. If we quit paying the Federal Government what little bit we're paying them now and gave a 22 mill cost to both and to National-Southwire, in March or April 1986 we would not be able to pay our coal suppliers, our employees wages, just day-to-day operating costs.

Senator McConnell. The lower coal cost that you referred to is going to save you close to $8 million?

Mr. Thorpe. It's going to save your consumers, Senator.

Senator McConnell. All right. That's going to be passed on to the consumers?

Mr. Thorpe. Yes, sir.

Senator McConnell. The residential consumers you mean?

Mr. Thorpe. Yes, sir; well residential and the aluminum industry. Now with our coal cost this year, well our total energy cost, including coal, that we're selling to National-Southwire for instance, it's average probably about 27½ mills. For 1986 their rate will be less than 27 mills as a result of these renegotiations of the coal contracts. Well a mill don't sound like much but when you're talking about 6 billion kWh a year between the two, that's $6 million just on 1 mill.

Senator McConnell. So tell me again what the relief to NSA and Alcan would be from the $7.8 million?

Mr. Thorpe. Well they would get approximately 70 percent of it.

Senator McConnell. What about the working committee, has that been helpful?

Mr. Thorpe. Yes, sir, I think it has more than anything else, Senator, for the communication between Big Rivers and the Federal Government. The banks were able to communicate with the Federal Government, but because of the litigation that was filed they had got to where they quit communicating with us and we had quit communicating with them and we suggested as early as last fall that a committee be set up to work together on these problems, which at that time they said that they were not in position for anyone from the Federal Government to participate in the meetings that we were having. But in, I've forgotten the date, but I believe it was March or April of this year, they finally agreed to set up, or join this committee with us.

Senator McConnell. I think that covers my list of questions. Would any of you like to add anything?

Mr. Thorpe. No, sir.

Senator McConnell. I appreciate your coming out.

Mr. Thorpe. Thank you, Senator.

Senator McConnell. I would like to call now Donald R. Norris the president and general manager of East Kentucky Power Cooperative.

STATEMENT OF DONALD R. NORRIS, PRESIDENT AND GENERAL MANAGER, EAST KENTUCKY POWER COOPERATIVE

Mr. Norris. Good morning, Senator, my name is Donald R. Norris, president and general manager of East Kentucky Power Cooperative. As you well know, I submitted my testimony for the record, it was about 13 pages in length and lists about 18 pages of exhibits. I will not, at this time, read that into the record, but instead present an oral summary of the points that I think are significant in the data that we have submitted to you.[1]

East Kentucky Power Cooperative is a generation and transmission cooperative that provides wholesale electric service to 18 distribution cooperatives in the rural areas of the eastern section of the Commonwealth of Kentucky. We are faced with a decision of when to schedule the completion of a 600-megawatt powerplant, the J.K. Smith Unit No. 1, and the financing thereof. It is now scheduled for completion in October 1992, but cancellation may even be the best option for us. At this point we believe a final decision on the fate of the Smith station should not be made for another 2, or possibly 3 years.

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[1] See p. 59 for the prepared statement of Mr. Norris with attached exhibits A and B.

When REA presented to East Kentucky Power Cooperative the prospect of merger or consolidation with Big Rivers we thought it might be a feasible alternative for us and Big Rivers. During the past year we have spent our money and a great deal of our time exploring this prospect. The results are accumulated in the Bechtel study which was submitted to REA.

Senator McConnell. Could I ask you a question?

Mr. Norris. Yes.

Senator McConnell. How did REA approach that issue, did they indicate to you that the future of the J.K. Smith plant was dependent upon your entering into these discussions with Big Rivers, did that sort of make you, or were you more than happy to explore alternatives?

Mr. Norris. Well, kind of a combination of the two I would think. They indicated that the J.K. Smith plant, of course, had been voluntarily rescheduled by East Kentucky Power Cooperative to an October 1992 date, and with load growth being what it was, there is concern that maybe it might not even be needed at that time, which I have addressed in my testimony. They said that possibly, with the Wilson unit being almost completed, that maybe that would be a viable alternative. Our management and our board took the position that we ought to look at it in detail to see if in fact it would be best. The Bechtel study accumulates the results of that.

Senator McConnell. So they didn't make you do it?

Mr. Norris. No, that's correct.

Senator McConnell. Go ahead. I'm sorry.

Mr. Norris. After the Bechtel study was submitted the boards of both East Kentucky Power Cooperative and Big Rivers then approved a memorandum of understanding based upon said study, which REA found unacceptable. I think Bill Thorpe has addressed that. We received the same letters, or copies of the letters that he did, wherein they had mentioned that they found it to be unacceptable.

We understand that REA and the other interested parties are exploring various options, including the memorandum of understanding. They have told us that in the August letter that Bill Thorpe referred to. I am unaware exactly of what progress, if any, is being made because that letter did indicate that they would get back to us in mid-September. As of yet we have not received anything from them. Obviously, I think for us and for anybody the sooner the better that something like that is taken care of, because it does affect our plans for our Smith station.

Senator McConnell. Is it your impression that the merger issue is sort of a dead matter now?

Mr. Norris. No, I would say that it's still a viable—it could be a viable option, depending upon what REA and the Government would do. We do feel that the Bechtel study very much summarizes the position of East Kentucky Power Cooperative. We went into that with our eyes wide open with the fact that the ratepayers, the 280,000 ratepayers of the 18-member systems we serve, should not be worse off with a merger than they would be if we continued to act independently. That is still our bottomline.

Senator McConnell. I mean the fact that you haven't heard from REA though doesn't lead you to conclude they might have written off merger as a——

Mr. Norris. No, I think not. Based on the letter, they indicated that they were studying the various options, including the memorandum of understanding, as I recall. I guess to summarize it I would say to you, to just accentuate a bit of what we've just discussed, that we certainly would be interested in participating in a total solution if we're requested to do so, but only as I've stated and I've written many times, and presented to our board of directors, and to anyone else, that if such a solution will not burden EKP's ratepayers any more than they would be burdened if we acted independently with our Smith station. And that's pretty well what our summary, or the summary of my testimony is about.

Senator McConnell. But you can afford, as you indicated, to just maintain the status quo. You've got another couple of years before you have to decide whether to go ahead with the J.K. Smith?

Mr. Norris. Yes; our powerplant is approximately 15 percent completed. In 1982 we decided not to go forward with it, it was originally scheduled to come online January 1985, then we postponed that until 1987.

Senator McConnell. That's a decision that's looking good in retrospect, isn't it?

Mr. Norris. Well, yes. Maybe some day it won't look as good as it appears to look now, but contracts are let, the site is developed, we believe that once we decide to go forward with it, assuming we maintain it in its current state of construction, that it is approximately 48 months away from completion. And so with an October 1992 date, starting engineering, getting contractors back on the job, finishing up awarding some of the contracts that have not yet been awarded, we would need to make a decision some time in 1987 or early 1988.

Senator McConnell. So you're not particularly concerned about the fact that you haven't heard back from REA even though they said they would get back with you in mid-September?

Mr. Norris. Well I'm always concerned when I do not hear from someone when they do indicate that they will do something, because if we are to proceed with construction of the Smith station, or whatever, it's important to use that REA and we work very closely together. The loan commitment from REA, which allows funds to be advanced for construction, expires in 1988, and it would require for us to proceed to obtain an extension of that loan commitment. So we are proceeding now to provide documentation and reasons to REA, and expect to have that to REA, hopefully by the first of the year, about an extension of that loan commitment.

Senator McConnell. But essentially you can put off for several years the decision about whether to go forward with J.K. Smith?

Mr. Norris. Yes.

Senator McConnell. You can afford to sit there for a while?

Mr. Norris. In-house studies indicate that it is not a penalty to our ratepayers to wait until 1988, late 1987 or early 1988, to decide to do this.

Senator McConnell. So if you were to decide to go ahead with J.K. Smith any time before 1988 it would probably be on the basis that the additional power was needed from another source.

Mr. Norris. Yes, it was either needed for our own consumers or a firm contract with someone else for the sale of power which really puts us in competition with Big Rivers.

Senator McConnell. The only other question I can think to ask you, if you were in Big Rivers' predicament what would you do?

Mr. Norris. I would do like the gentleman earlier and try to dodge that if I could right now. It's a very concerning and a perplexing problem. I would say the foreclosure is unprecedented really in our business.

Senator McConnell. Well you deal with REA all the time, do you think that was a mistake for them to do that?

Mr. Norris. I don't know as I can answer that exactly. It's different, and it certainly puts a new concept into the dealings, that's for sure.

Senator McConnell. You think it got their attention, Big Rivers that is?

Mr. Norris. I don't think there is any question about that.

Senator McConnell. Thank you very much for coming.

Mr. Norris. Thank you.

Senator McConnell. I would like to call at this time the county attorney of Hancock County, Harold Wayne Newton. He and I were in law school together at U.K. back during the Coolidge administration.

STATEMENT OF HAROLD WAYNE NEWTON, COUNTY ATTORNEY, HANCOCK COUNTY, KY

Mr. Newton. Good morning, Senator. First of all, Senator, let me thank you for your efforts in behalf of trying to solve this problem. I'm here today to just give a very provincial view of this problem and how it affects Hancock County. Some of the investment bankers that were here earlier were talking about millions and millions of dollars, and I know that's very important to them, but how this is going to affect the people in Hancock County is very important to me.

I have prefiled my testimony and I'm not going to go through the whole thing again, but I just want to highlight some of the things here.[1]

I don't want to blame anybody for the crisis we're in here today because Big Rivers and National-Southwire are both important industrial citizens of Hancock County, and they're very important to us.

You mentioned that we were in law school together and you know you went your way when we got out, and I went back to Hancock County, primarily because I could see that I could make a living there. Up until that time it had been a little rural farming community, and if you wanted a job you had to move away, you had to go to Gary or Indianapolis or somewhere like that, but when NSA and some of the other industries came to Hancock County we saw then that there were employment opportunities there. Big Rivers itself employs about 130 people in Hancock County. NSA and its associate concern, Southwire, employ about 1,100 people, and over 300 of those people live in Hancock County itself. The rest of them live in surrounding counties. They pay millions of dollars in taxes each year through all of the counties. They pay several hundreds of thousands of dollars in taxes in Hancock County alone.

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[1] See p. 74 for the prepared statement of Mr. Newton.

The effect of this, the great number of dollars of taxes that they pay is that we have one of the best school systems in the State. We have a park system there that is one of the best in the State. We provide services in the way of ambulance service with trained EMT's; our sheriff's department is up-to-date; our road system is a very good one; and the county is able to make contributions to senior citizens' programs and other services for the people in our county. NSA and Big Rivers people are important to the civic needs of our county. They furnish people who serve on the boards and the commissions in the county and see to it that the every day things of the county are done and the government is run properly.

Now, we all know, I think, that NSA is not going to survive unless this crisis is solved. And if NSA goes down, Big Rivers is certainly going to lose part of itself. The Coleman plant that's located in Hancock County will probably go down too. The net effect of all of this is going to be the loss of hundreds of thousands of dollars of tax revenue, as well as the payroll that is generated. As a former county judge executive I am sure you can realize what effect that's going to have on county government if we lose over 20 percent of our general budget each year. Now, the "ripple" effect of that is going to be felt throughout western Kentucky. There's going to be coal miners, truckers, jobbers, and suppliers, they're all going to lose their jobs.

The investment bankers know exactly how many dollars they're going to lose in this. We can't measure, however, the loss that's going to be felt in Hancock County if we don't solve this. There's going to be the loss of jobs, there's going to be bankruptcies, the price of real estate is going to just plummet, and you have all of the other immeasurable losses that we would see in this situation.

I don't have an answer to it, Senator, I don't know where we're going to go from here. I do know that for that little county up there along the Ohio River this is probably the most important thing that's faced it in its existence.

As was said earlier, someone said that if this is not solved it's going to be like an atomic bomb going off in western Kentucky, and if that happens the center of that bomb blast is going to be Hancock County. I don't want to have to go back to the days before NSA and Big Rivers and the other industries thrived in Hancock County. It's not going to be a good place to live if we can't solve this. It's not going to be a good place for us to attract new industries or new people in many many years to come if we don't solve this.

As I said, I don't have an answer, but I do want to point out to you the tremendous importance that this has for all of the citizens of Hancock, Daviess, Ohio, and surrounding counties, and hope that you and some of the other bright people that are here in this room and have worked on this can come up with a solution, and one that will keep us in mind and not just the monetary figures that REA and the investment bankers and NSA and the others are concerned about. We want you to look at the human factor in this case.

Senator **McConnell**. I want to thank you, Harold for coming out and explaining the devastating effect on Hancock County of closure of NSA. Having been there this summer and having toured the plant and talked to the people it's pretty clear that what you're saying is absolutely correct. Some of the other counties maybe have a few more options than you all do, but clearly a good percentage of your eggs are in this basket and I think that really does add an extra dimension to the hearing, and I appreciate your coming.

Mr. **Newton**. Thank you.

Senator **McConnell**. I would like now to call Senator Ken Gibson who is here testifying today on behalf of Kentuckians for Affordable Energy.

STATEMENT OF KENNETH O. GIBSON, A KENTUCKY STATE SENATOR, ALSO CHAIRMAN, KENTUCKIANS FOR AFFORDABLE ENERGY

Mr. **Gibson**. Senator McConnell, I am Kenneth O. Gibson, senator from the Sixth District of western Kentucky made up of four counties, two of them major coal producing counties, Hopkins and Muhlenberg, that's a position I've held for some 13½ years. I also serve as chairman of Kentuckians for Affordable Energy for which I combine my comments today.

I come before you today out of concern for my constituents in western Kentucky, and for all the ratepayers who are plagued by ever increasing electric utility rates. Specifically, I've been concerned about the overbuilding of the Big Rivers electric system and the costs of adding the 440 megawatt Wilson plant to its system, which is not needed or useful in its service area.

As a result of this hearing and ultimate decision process, you must either tell the existing ratepayers that they will begin to pay for the Wilson mistake or you will put REA on notice that it may have to shoulder the burden of a decision in which it has been a party to from its inception.

The issue before us is who will be forced to pay the bill and how the problem is to be solved.

In this case, while many mistakes have been made, the fact remains, that either the ratepayers of Kentucky or the Federal Government agency, REA, will have to bear the cost.

These are the only two factions that can be considered responsible. So, the question comes down to which one will pay?

If the Federal Government is responsible for the Wilson project, it is unethical to put the burden on the innocent ratepayers who have no choice but to trust in the utility companies and, in this case, REA decisionmakers in Washington.

I do not believe it can be justified to make the ratepayers of western Kentucky absorb this debt. To place this enormous burden on one section of Kentucky would be economically disastrous. As our commerce cabinet could attest, you would not only eliminate all potential for industrial growth and expansion but also for retaining those existing industries which are now served by Big Rivers.

REA, on the other hand, was instrumental in every decision made on Big Rivers' Wilson project. REA approved the construction plans based upon REA approved power forecast studies. Studies, which, in part, included power needs for proposed synfuel plants that also were supported by the Federal Government during much of that determination period.

Big Rivers acknowledged REA's control through provisions in the loan documents securing its loans which state that REA has substantial rights to control and supervise its electric cooperative borrowers in accounting and other areas. The documents also generally: Require the approval by REA of any contract relating to, among other things, the construction of the cooperative's system; require a pledge of all the cooperative's rights under its contracts and agreements; subject substantially all of the cooperative's properties, contracts, incomes, and revenues to the lien of a first mortgage securing all the cooperative's present and future indebtedness to REA; and restrict the nature of investments which may be made by the cooperative.

So, it is quite evident that REA approval is required for all power generation costs undertaken by borrowing electric cooperatives.

REA even sent a representative to Big Rivers' monthly board meetings and that representative submitted field reports summarizing each meeting attended.

So, I say again that the Wilson project could not have come to fruition without major Federal decisions and approval. The decisionmaking bodies which handed out approval must now accept the major responsibility for the impact of those decisions.

The alternative of inflicting a debt of this magnitude on the people of western Kentucky would have a devastating effect on the lives of over 600,000 individuals in 22 counties, and perhaps many more in surrounding southern Indiana and southern Illinois.

Of particular concern to my district in western Kentucky, is the impact of putting rate increases into effect that would force National-Southwire and Alcan Aluminum to close their plants.

This would not only mean a direct and immediate loss of approximately 1,800 jobs, but the immediate elimination of the need for 8,000 tons of coal per day needed to power those 2 plants.

This equates to the loss of another 950 coal mining jobs following TVA's shut down of their camp complex and the layoff of 1,400 coal miners, a problem that hopefully you have been a part of the solution—partial solution anyway, Senator. This layoff of coal miners would just be the beginning of our problems in western Kentucky. If NSA terminates operations, Big Rivers' rates will increase appreciably, but if NSA and Alcan both terminate operations, the Big Rivers' rates will increase dramatically.

If we have such a massive increase in REA rates in western Kentucky, how extensive will the domino effect be as the remaining customers have to share the impact of rate increases for each customer lost to the system? Or, as one top Big Rivers official has said, it will be a question of who will be the last surviving customer trying to pay all of the Big Rivers bill.

One answer to the problem is for the Wilson station to be excluded from the Big Rivers system and the losses associated with the Wilson project not be passed on to the established hardworking ratepayers of Kentucky.

They cannot afford to pay for the Big Rivers mistake and REA's miscalculation. It would mean economic ruin for many, many families and businesses, as well as the larger industries. Thousands upon thousands of jobs would be eliminated, taxes would be greatly diminished, schoolrooms would be empty, and welfare rolls would swell way out of proportion.

Surely, the people deserve protection from this potential disaster, and yet the hour of decision is near. Will REA's face-saving efforts overshadow Kentucky's call for justice and fair play? I think not, because the issue is of such magnitude that the lines must be drawn, and a resolute stand must be taken.

All fairness demands that Kentucky's interest be zealously protected, for the future of western Kentucky literally hangs in the balance. The Federal Government is responsible, and should sustain the loss under normal banking practices similar to the bankruptcy laws of this country.

Senator McConnell, I sincerely appreciate the opportunity to appear before you here today. I want to personally thank you, along with Senator Ford and Congressman Hubbard, for your recent efforts on behalf of our 1,400 laid-off coal miners, hopefully we have a solution to that.

It is also most gratifying that you have taken the initiative to have a hearing on this most critical of issues. As I have tried to point out in my testimony, the pending impact of REA rate increases on western Kentucky is of such magnitude, that we need and deserve a sympathetic ear in Washington.

You, as a member of the Senate Agriculture Committee, are a welcome sounding board. If western Kentucky ever needed a champion in Washington, it is now. Whatever you can accomplish on behalf of our people will be long remembered.

As a young Senator, your measure of resolve on this issue could serve as a beacon in western Kentucky as to your promise for the future.

On behalf of those people, I thank you for your efforts.

Senator McCONNELL. Thank you, Senator Gibson. I appreciate your mentioning the TVA Camp complex solution last week. If ever there were apparently insoluble problems that was it, and as a result of three or four meetings that Senator Ford, Congressman Hubbard, and I had with the players there, closing those mines was averted. It's almost similar to this, the meetings didn't take as long, but it appeared to be about as hopeless.

As you indicated in your statement, passing on the cost of this miscalculation to consumers is something no one is advocating, no one here today has advocated it, and we don't anticipate that that will happen.

I think all of the projected solutions fall into three categories now, selling the system, selling part of the system, or selling the power or merging, and I think that's going to be the focal point of activity here. As far as I'm concerned, I couldn't agree with you more, that sticking it to the innocent consumers, particularly the

72,000 residential consumers who had nothing to do with the management decision that brought about this fiasco is an unacceptable option.

I think that the Federal Government does share a responsibility for the decisionmaking in this, they were a part of it all along the way, and in my judgment need to be a constructive part of the way out of it.

Senator Gibson, just for my information, tell me about Kentuckians for Affordable Energy.

Mr. GIBSON. Sir, this is an ad hoc group formed back in early summer of 1984 pending the—at that time advertised rate increase hearings before the Public Service Commission. It was formed to try to alert and educate the general public as to the impact of those projected rate increases that were somewhere in the neighborhood of 44 percent over a 3-year period. So I felt like that this was an issue of such great magnitude, as I've said in my testimony, to the people of western Kentucky, they certainly ought to be informed as to what was about to happen to them, and as you know even though while the decision may be today that we're not going to try to pass those rates along to the consumers, that hasn't always been the case, as REA had pressed Big Rivers to increase their rates to make up for the cost of the Wilson 1 plant.

So it was formed and we had planned an extensive advertising campaign to alert the general public which was modified after meetings with various legislatures, Senator Ford, Big Rivers, and those people that would be affected such as National-Southwire and Alcan, and there were some agreements reached that precluded an all-out campaign against Big Rivers rate increase at that time. So while we were geared up to do an extensive effort that hasn't been necessary because there has been a great deal of communication and cooperation in the efforts between all the parties that are affected.

Senator MCCONNELL. Well, as you indicated, of course, the rate decisions are going to be made in Frankfort, not in Washington, and I think it's good that there's an organization like this that's representing the consumers of western Kentucky.

The other thing that we all need to work on, I think is particularly important in Frankfort through the commerce cabinet, is greater efforts to lure new industry to western Kentucky. It would be great if we had some more users for this power, and I know that's something that you and others in State government spend a lot of time working on.

Mr. GIBSON. Of our great interest, yes. We'd like to salvage what we have too.

Senator MCCONNELL. Absolutely. Thanks for coming. Appreciate it.

Mr. GIBSON. Thank you.

Senator MCCONNELL. I would like to call at this point, Paul Belanger, who is the plant manager of Alcan.

STATEMENT OF PAUL BELANGER, PLANT MANAGER, SEBREE ALCAN ALUMINUM PLANT

Mr. **Belanger**. Good morning, Senator McConnell. As you are aware I am the plant manager for the Sebree Alcan Aluminum plant located off the Pennyrile Parkway, and Alcan and its employees would like to thank you, Senator McConnell, and the Senate Agriculture Committee for coming to Henderson and giving us an opportunity to testify today.

What I would like to do first in referring to my prefiled testimony [1] is to put Alcan's power cost in perspective with the rest of the aluminum industry, not only in the United States, but on a worldwide basis. It's become obviously—it's very obvious that we consume 35 percent of Big Rivers baseload power. And a total electrical cost at our plant accounts for about 38 percent of our total costs.

Now, we estimate that our costs are about 45 percent higher than the average power costs of other U.S. aluminum producers. I would also like to point out that a number of competing aluminum companies have requested substantial rate reductions, such as Alumax in South Carolina, National-Southwire obviously in our system, and Noranda in New Madrid, MO. In the Pacific Northwest, the Bonneville Power Administration recently granted a rate relief to the largest concentration of smelters in the United States, and that was in recognition of the dire straits that the aluminum industry has found themselves out there.

Other aluminum companies, on the other hand, have curtailed high power cost aluminum reduction facilities, such as Alcoa in New York, Reynolds in Arkansas two plants just as recently as October 15, and Noranda who has just in the past 2 weeks curtailed another half-a-line in Missouri. Over the last few years, all of the smelters located in the Tennessee Valley Authority service area have been permanently closed with the exception of those which have long-term preferred power contracts. The permanent closure of those facilities, along with the rate relief from the BPA has, of course, reduced the average power costs of the U.S. smelters which continue to operate to approximately 21 mills.

The average power price at foreign aluminum smelters on the other hand is approximately 17 mills or less. That low cost, along with the positive effect which the strong U.S. dollar is having on foreign smelters' other production costs, is placing the U.S. domestic aluminum smelters in a great deal of jeopardy.

Now, Mr. Thorpe has already referred to a proposal for indexing the price of electricity to Alcan based on the selling price of aluminum. Some discussion—or similar discussions have also been taking place with the smelters in the Pacific Northwest. Our proposal was for 2 years and would have provided for lower power rates as long as the aluminum prices remained below a benchmark price. As the price of metal increased, we had guaranteed that we would have paid a subsequently higher rate to pay off any deficit. That was in recognition of the fact that—in recognition of the fact that Big Rivers does not have a bank from which to draw, such as they have in the Australian plan, we guaranteed them that we would pay any accrued demand charges, plus interest on those demand charges. In other words Big Rivers was guaranteed revenues equal to what they would have received under the current contract, and Alcan would have been able to defer some of their costs. Big Rivers studied our proposal, they expressed to us a great deal of interest, but so far we have had no further action.

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[1] See p. 77 for the prepared statement of Mr. Belanger.

The other premise I would like to deal with, which is a second, entirely separate, issue has been the fact that Big Rivers does not need the Wilson powerplant. It has tried to sell the facility or alternatively enter into a long-term power sale contracts.

There may be a misconception that if Big Rivers sells the Wilson plant, their problems and the aluminum companies' problems are solved. However, this is not the case. The power rates which we are currently paying presently do not include any costs associated with the Wilson plant. As I have previously stated, those rates are, nevertheless, still well in excess of the U.S. average. With the current rates, we have already curtailed one-third of our production and laid off or terminated 250 employees, which was about 30 percent of our workforce. I would like to point out that the decision to cut production was made when metal prices were approximately 48 cents on the London Metal Exchange, and they have recently fallen to below 43 cents and each cent represents a revenue reduction for the Sebree smelter at its present operating level of approximately $2,500,000 annually.

In April of this year, over 7 months ago, when business conditions were stronger than they are today, Alcan told the Kentucky Public Service Commission, and I quote: "We are paying more for electricity in Kentucky than 96 percent of all the smelting capacity in the world." In addition, Alcan witnesses told the Public Service Commission, quote: "These rates put the Sebree smelter in a precarious position and make it a prime candidate for shutdown." I would like to reemphasize those statements today, because selling the Wilson plant will not give us 1 penny of relief from our current power rates.

Today's aluminum prices are the lowest they have ever been in real terms. Even some of the low-cost producers that indeed have a hydroelectric power are suffering. Almost all of the aluminum companies reported losses in the third quarter.

Imports, no doubt, have a big effect on the U.S. aluminum market. Many foreign smelters are Government owned or subsidized to create jobs or export cheap power in the form of aluminum. By exporting their aluminum in exchange for U.S. dollars, the producing countries improve their balance of payments. With the strong U.S. dollar, many of these producers have actually realized aluminum price increases when the aluminum transactions are converted into their currencies. Effectively, they are exporting cheap power. Meanwhile, the U.S. aluminum companies have seen London Metal Exchange prices fall from about 72 cents in early 1983 to the recent low below 43 cents, and the prices have been hovering around 47 to 48 cents for the past year. It's also been widely publicized that the break-even point for most U.S. smelters is believed to be between 54 and 60 cents per pound. So the mathematics become very simple.

Current analysts' projections are that worldwide aluminum inventories must decrease substantially due to further curtailment of primary production for an appreciable price increase to occur. We, on the other hand, at Alcan would prefer to keep running and wait out the current severe problems. To do this, however, power price concessions will be required.

I would like to just briefly summarize some important points:

Our power costs are indeed 45 percent higher than the average power cost of other U.S. smelters;

And there are indeed other U.S. aluminum companies which have already curtailed or permanently closed high-cost reduction facilities;

In order that Alcan remain competitive, we will need some variability in the cost of our power, such as the indexing proposal;

And most importantly, solving the Wilson plant problem will not improve our current power rates;

The aluminum market is worse than it was 6 months ago, and unfortunately doesn't show any signs of any near term improvement, nor is any forecasted.

Senator McConnell. On that happy note, let me ask you, that even if Big Rivers were able to unload the Wilson plant, hypothetically it would help you if they were able to sell power off the present system, would it not?

Mr. Belanger. If they were to sell power off the present system, it could indeed possibly lower our rates.

Senator McConnell. Tell me what rate you would need to break even.

Mr. Belanger. That's unfortunately an economic decision that can only be made at some point in the future. Presently Alcan continues to operate the smelter at a power rate which is very much higher than we would like. Our power costs, our production costs are obviously in the average of the U.S. system power—operating costs for other smelters, and that's not a decision we want to make. We have taken the position so far that we will try to weather the storm. I can't really answer that, it's just something we will look at in the future.

Senator McConnell. Did you join NSA in its request to the Public Service Commission for a rate reduction?

Mr. Belanger. At the hearing before the Public Service Commission last spring we were an intervenor and fought the proposed rate increase with—against Big Rivers. On the other hand, we have been trying to find solutions to the problem and, therefore, that's why we propose the—we made the indexing proposal.

Senator McConnell. When do you anticipate a rebound in the aluminum markets?

Mr. Belanger. Currently the metal market analysts are saying that the only way a price increase will occur is if there is some permanent closure of reduction facilities. Some—depending on which analyst you listen to—they say it could come as early as the early part of 1986, and some say the price may indeed recover to approximately 65 cents, maybe 70 cents, by the end of 1986 or early 1987. I'm not really optimistic at this point.

Senator McConnell. You may have answered this earlier, but have you pursued the possibility of another variable rate contract with Big Rivers?

Mr. Belanger. No, we have not.

Senator McConnell. Why not?

Mr. Belanger. That was the only proposal that we have that really makes sense to us at the moment. Actually the proposal that we had made said that at a certain price of aluminum we would pay—we would always guarantee the payment of the energy charge which is on the order of about 19 mills. Our actual cost, even at a reduced level of operation where we continue to pay the demand charge for all three lines, whether we operate them or not, has—is with an effective rate of about 31 mills. Being cognizant of the fact that Big Rivers does not have a bank, but the REA is not about to provide one, the State of Kentucky does not have one, it became very apparent that Big Rivers still had to be able to continue to repay their debts if they were going to remain solvent and, therefore, our proposal, in effect, killed two birds with one stone. We deferred a cost now but guaranteed their solvency because they would have had a commercial piece of paper which would have guaranteed the loan.

Senator McConnell. Thank you, Mr. Belanger, I appreciate your coming.

Mr. Belanger. Thank you.

Senator McConnell. I would like to call now Garry Satterwhite, vice president and general manager of National-Southwire Aluminum Co.

STATEMENT OF H. GARY SATTERWHITE, VICE PRESIDENT AND GENERAL MANAGER, NATIONAL-SOUTHWIRE ALUMINUM CO.

Mr. Satterwhite. Good morning, Senator. We are pleased that you and the Senate Agricultural Committee are taking an active interest in the western Kentucky power problems and initiated this hearing to provide a forum to generate potential solutions.

Since you have my prefiled testimony and a number of points that I've made have been covered by other people I'm just going to, with your permission, to leave part of it and maybe add a modifying comment or two on some of the points I think that need addressing.[1]

Senator McConnell. That will be good.

Mr. Satterwhite. This is a critical time for western Kentucky and National-Southwire Aluminum Co. The question is: Can we survive this troubled time in the American aluminum industry and not be forced to consider options that might result in devastating economic effects to all of western Kentucky and portions of southern Indiana? The necessary first step is to establish a competitive price for the power which we need to continue to operate our plant, and to make aluminum.

We have been victimized by a combination of low aluminum prices and higher than average energy charges for aluminum smelters in the United States. We presently pay more for electric energy per pound of aluminum produced than any other aluminum producer in the country.

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[1] See p. 79 for the prepared statement of Mr. Satterwhite with attached reprint.

Other aluminum producers, whose power costs have always been significantly lower than NSA's, have recently obtained rate relief, putting NSA at even a greater disadvantage competitively. These other utilities, which include the Bonneville Power Authority, the Santee Cooper Power Co. which is South Carolina owned, State-owned agency, and the New York Power Authority, have obviously recognized the importance of jobs and the benefits afforded them by having a large, steady load as an anchor to their consumer base and have taken measures to ensure their survival. We believe that Big Rivers and REA can and should do this for NSA. Big Rivers has, in fact, made one proposal to us that would appear to lower the cost of power during periods of weak aluminum prices. This scheme, however, involved borrowings by Big Rivers to cover their deficit, which would have to be repaid, with interest, by NSA within the 2-year period. You've heard that described earlier. We rejected this proposal because we felt that further borrowing to cover excessive power costs is not a solution to the excess power costs problem and high rates, and is certainly not in the best interests of the ratepayers.

Now there have been a number of references to the Australian plan, and the Australian plan was submitted in testimony in the recent rate case involving the Wilson 1 plant. This was filed by a vice president of Alcan. And I'd like to—I just reviewed this Australian plan this past week, Senator. The aluminum company involved, Alcoa of Australia, as part of this plan, the first thing that happened was they were released from all previous contracts and commitments to buy electricity. Second, the power price under the new agreement was linked to the price of aluminum. The absolute ceiling price of power was 20 percent of the metal price. NSA today pays over 43 percent. Third, the state of Australia—the state of Victoria in Australia agreed to contribute up to an estimated $107 million to a fund to be used by the electric utility to offset the deficits incurred on power sales to the aluminum company. Fourth, the aluminum company agreed to contribute to cover those deficits only if, and to the extent, that aluminum sold for more than 77 cents a pound. In 1982 when this contract was evolved, aluminum was selling for about the same price it is today; that is, in the range of 45 cents a pound. So if we apply the principles of the Australian plan to the NSA-Big Rivers situation this is how it would look.

First, NSA would be released from its present power contract.

Second, a new contract tying power to the cost of aluminum price would be agreed upon with power costs to represent no more than 20 percent of aluminum selling price, instead of the 43 percent it represents today. This would cut NSA's power bill in half immediately.

Third, some government entity would have to guarantee $100 million or more to cover the short falls incurred by Big Rivers.

Fourth, NSA would have to make up the deficit only if, and to the extent, that aluminum sells for more than 77 cents a pound, but the total power cost could never be more than 20 percent of the aluminum selling price.

Well, Senator, I can tell you that NSA would be happy to accept such a plan, as the true Australian plan, and I'm sure that the parents of NSA would happily guarantee the obligations under such an arrangement.

Basically, we believe that Big Rivers should take the same action any company should take that finds itself in an untenable economic situation. They should renegotiate their coal contracts, eliminate all wasteful and unnecessary expenses, restructure their financial obligations and seek to sell additional power in order to add revenue to the present generating system.

Big Rivers now finds itself with far more generating capacity than it needs even without counting the Wilson plant. We feel that Big Rivers would be justified in offering NSA, and others, demand price breaks for large blocks of steady load power demand, much as the old concept of the declining block rates for power which we initially had back in the early seventies. This incentive demand change, along with cost reduction efforts such as the lower price coal contracts, which they told us about today, should allow for rates to NSA in the 22 mill range, which is about the average power rate paid by smelters in the United States.

As previously mentioned, other aluminum smelters have closed recently because of high electricity costs, the Reynolds plant in Arkadelphia and Jones Mills, AR, and the Martin Marietta smelter in The Dalles, OR, for example. If NSA cannot operate economically, the effect will go far beyond the direct loss of jobs and payroll at Hawesville. Big Rivers should consider what it would do if it loses its largest source of revenue, then Big Rivers and REA will be in an even worse financial condition than the present one. We at NSA feel that we are doing all that we can do to help ourselves. We too have cut wages and salaries, reduced staff, renegotiated other raw material contracts.

We feel as many others have expressed today that REA has a major role and responsibility in this affair. We believe that they should consider some innovative financing options which would include the extension of time for the repayment of loans to Big Rivers on the present generating system. NSA presently pays over $80 million per year for electricity. Should we be forced out of business because of high power rates, then Big Rivers would have to find some other way to make up for this revenue loss. They would not be able to turn to NSA's parent companies because they are not parties to our contract with Big Rivers. However, I believe that National Aluminum and Southwire, the parent companies, would be willing to consider a guaranteed contract if we could be assured of a competitive power rate in the future.

We recommend that REA consider accepting a moratorium on the debt payment, both principal and interest, related to the Wilson 1 power station for an indefinite period and to credit all the power sales to the existing system for the same period.

Let me say that the possible sale and credit to the present system of 200 megawatts that we heard this morning is really a good piece of news to us. Somehow it just makes more sense to me for Big Rivers to defer $16 million to a present Kentucky customer than to sell cheap power and thereby subsidize customers of Mississippi, Alabama, and Tennessee which are competing with Kentucky for new industries.

To summarize, the solution that we think would—that might possibly be a solution of course is for Big Rivers to do everything possible to lower their out-of-pocket costs which they've indicated that they're making good steps on this. Second, would be to sell the power at decent rates and credit it to the present system. And the third is for REA to be reasonable and help them work out rescheduling their debt or moratorium on their debt.

The one thing that we can't do is continue to delay. Like someone else stated this morning, time will not solve our problem. Time, for us, is running out, and we need to have a resolution to this problem very soon.

Thank you, Senator.

Senator McCONNELL. Thank you, Mr. Satterwhite. Since National-Southwire first raised concern about the cost of its power, what's happened to the cost of aluminum? Has it decreased any further?

Mr. SATTERWHITE. Yes, sir, it has. It has decreased for the last 2 weeks, very slightly. It's down around 43 cents a pound now.

Senator McCONNELL. How much money would you estimate NSA is losing each week?

Mr. SATTERWHITE. Well we lose about $100,000—over $100,000 per day, so that's $3 million a month.

Senator McCONNELL. With the status quo how much longer can you last?

Mr. SATTERWHITE. It's hard to answer. Again, like Mr. Belanger said it depends on the result of our parents. We do have some hope that the metal price will change in the future, and that's the reason we continue to operate because if we did shutdown it's so expensive to restart pot lines. We figure it would cost about $2 million per pot line to restart, and that makes it—once the plant is down it would—we would even need a lower power rate than 22 mills in order to make it.

Senator McCONNELL. You alluded to some of these, but other than power costs, are there other areas of your business that can be streamlined to reduce your costs further?

Mr. SATTERWHITE. Well we have identified some modifications we can make to conserve energy, and we testified to this at the last Public Service Commission hearing, and unfortunately it will take about $15 million in 6 years to complete those, and the parents are not willing to commit that until they see some sort of long-range solution to the power problem.

Senator McCONNELL. You mentioned that other aluminum companies have received relief from their utilities, do you know whether those utilities were coal fired or were they hydropower?

Mr. SATTERWHITE. Well Santee Cooper, which is South Carolina Public Power Authority, was coal fired. And what they did is they gave Alumax their demand charges for this year. The BPA is principally, in fact it might be totally hydro.

Senator McCONNELL. How much relief did the coal fired utility provide?

Mr. SATTERWHITE. I think it was $13 million a year.

Senator McCONNELL. You outlined several ways in which Big Rivers could reduce its costs; one of those suggestions was to renegotiate their coal contracts. Big Rivers, I think, has done that. Mr. Thorpe has already mentioned that. What else do you suggest that they do?

Mr. SATTERWHITE. Well, they—and I think Mr. Thorpe indicated they're doing this also—they have not given any raises to their people, other than those that are covered by labor contracts, they've cut out donations, seminars, this type of thing. I can very much sympathize with Mr. Thorpe in this regard, it's a—basically it's a, sort of a token because you—we calculated that if everybody at NSA worked absolutely for free we would still be losing money. But the other major point, Senator, is the credit—the sale of power to the present system. Some of that is going to Wilson, as they indicated, some of it is going to the present system, but if all went to the present system that would have the biggest effect.

Senator McCONNELL. You described at some length the Australian plan, not only did you all reject that plan, you threatened to file a lawsuit, why did you do that?

Mr. SATTERWHITE. Well, several reasons, Senator, the first one is that we didn't feel that it—it just didn't make any sense to borrow more money, even for a short period of time, even though they would have been repaid that money at the end of 2 years, plus we had some indication that there might be a reduction in the term of the contract for Alcan linked to their power contract and this was one of the basic reasons we'd oppose that. We both have our term extending to the end of 2010.

Senator McCONNELL. Did you try to negotiate any other kind of variable rate contract with Big Rivers?

Mr. SATTERWHITE. Yes, we did. We made proposals to Big Rivers before they came back with the so called Australian plan which tied the price of power to the metal price on a sliding scale. And we never heard back from them on that one.

Senator McCONNELL. If the PSC were to allow you a lower rate, how would you justify the special rate to the other consumers, and how would the difference be made up?

Mr. SATTERWHITE. Well, by granting us a favorable rate that would assure our continued operation the remaining ratepayers will be in much better position with regard to electrical rates than if we had to close the plant. We also feel that we have been subsidizing other ratepayers for a number of years and a—deserving a special consideration. The precedent of establishing special rates in order to permit aluminum industries to continue to operate in an area has already been said as mentioned by testimony of several people, in other words the power rates set at the Bonneville Power Administration which is a Federal agency for the direct service industries in that area.

Senator McCONNELL. You said that Big Rivers should credit power sales to the present system first, thereby possibly reducing rates to the consumers. REA told my office this week that the entire surplus, including Wilson, was 419 megawatts, and of that 24 was on the existing system.

Mr. SATTERWHITE. Twenty-four megawatts surplus on the existing system?

Senator McCONNELL. That's what REA said.

Mr. **Satterwhite**. Well I believe that even Mr. Reed made a statement this morning that they had 200 megawatts, and I think we would dispute the fact that maybe that's too low, but accepting the 200 megawatts if that could be sold at 38 mills—we did a quick and dirty calculation, so to speak, this morning, that would reduce everybody's rate by about 4.5 mills per kilowatt-hour.

Senator **McConnell**. It's obvious that REA is really clued in to what's going on. In your estimation what is Big Rivers' present excess?

Mr. **Satterwhite**. Well we say it's—we claim it's 400. We had a dispute about that in the last rate case; I don't think it was ever resolved, 400 for the present system. They claim it's 200.

Senator **McConnell**. How much have you discounted for reserve capacity?

Mr. **Satterwhite**. 20 percent.

Senator **McConnell**. And where did you get those figures?

Mr. **Satterwhite**. REA form 12.

Senator **McConnell**. Is NSA a principal in the working committee put together by Judge Johnstone?

Mr. **Satterwhite**. Yes, we are. We have an attorney representing—that represents us is also on that committee.

Senator **McConnell**. Are you playing an active role on the committee?

Mr. **Satterwhite**. Yes, we have attended all the meetings.

Senator **McConnell**. Did NSA help to finance ICF study which is going to be issued shortly?

Mr. **Satterwhite**. No, we did not. We were interviewed by the—some of the consultants, but we did not finance it.

Senator **McConnell**. Thank you very much, Mr. Satterwhite.

Our last witness is Richard D. Heman who is chairman of the Kentucky Public Service Commission.

STATEMENT OF RICHARD D. HEMAN, JR., CHAIRMAN, KENTUCKY PUBLIC SERVICE COMMISSION

Mr. **Heman**. Thank you, Senator. Is it all right if Mr. Raff of our staff accompanies me? We, a few days ago, prefiled a rather short, not extensive testimony, which does I suppose look backward as to where—expresses the concerns of the commission. They have been stated here this morning by others so——

Senator **McConnell**. I think if you could summarize your statement that would be helpful.[1]

Mr. **Heman**. Well, again the concern is, I suppose obvious, the fact that we have 70 to 75 percent of the load associated with the aluminum industry, the fact that what higher rates would do to the residential customers of Big Rivers.

We discussed in the prefiled testimony some of the cases that the commission has had, the rate case, the sale/leaseback proposal which faltered, and which the case was eventually withdrawn, and then another case which was supposed to be a non-Wilson plant rate case was brought before the commission. And the commission did award no revenues as it determined that removing the Wilson plant from that particular rate case would—could not justify any increase or what could be justified would be to minimus, so that was disallowed.

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[1] See p. 84 for the prepared statement of Mr. Heman.

We do have a complaint case before us now of National-Southwire to reduce the rates applicable to Southwire. Big Rivers has filed an answer, as well as a motion to dismiss, so that matter is pending. They seek to reduce that rate, I think, to 22 mills.

We commented briefly in the prefiled testimony upon the alternatives, the fact that bankruptcy, which perhaps maybe I speak for myself here, does not appeal to me. The hope is that the REA, and you expressed this at the very beginning at 10 o'clock this morning, is that the REA would—the Rural Electrification Administration would recognize that they're involved in this also in a different way back from beginning, and that they would look at a possible restructuring, or some way, in which to help Big Rivers, assist in making sales from the plant or restructuring this debt is the main concern to find a way out of this dilemma and also to preserve the economy which the Senator and the gentleman from Hancock County discussed which—it's a very big concern of the commission, the effects on the economy, on the aluminum industry, on Big Rivers. I was a member of the staff for many years before going on the commission, I was there, which really dates me as to when Big Rivers was constructed, and we want to see a solution.

And again I know that—I think you alluded, Senator, to the General Accounting Office report on Big Rivers which indicates to me that there is some—that the Rural Electrification Administration maybe did not pick up the ball at some points along the line. So I just would—somewhat disappointed in that approach, and I would hope that they would consider becoming a part of this solution.

Senator McCONNELL. Did the U.S. Government make any comment about the NSA request before PSC?

Mr. HEMAN. The one that's before the commission now?

Senator McCONNELL. Yes.

Mr. HEMAN. No, sir, not to my knowledge.

Senator McCONNELL. Did you have other points to make, or do you want me to go ahead with my——

Mr. HEMAN. I don't think so. I was pleased to hear that the coal contracts are being negotiated, that's a help.

Senator McCONNELL. That may be the good news of the day. Shall I go ahead and propound a couple of questions?

Mr. HEMAN. Yes, sir, I think so. I was just looking over a few notes, and I could just say as far as proposals, it's difficult to comment specifically on proposals which may come before the commission. It would be hard to definitively comment on those things, but fire away, sir.

Senator McCONNELL. Let me ask you, the PSC ordered Big Rivers to negotiate with its two aluminum customers to tie their electric rates to the price of aluminum. Did the commission participate in the negotiations on the Australian plan?

Mr. HEMAN. No, sir, the commission did not participate. In the order entered last spring, as you state, we did encourage those negotiations, we indicated that the commission should be——

Senator McCONNELL. You requested that the——

Mr. HEMAN [continuing]. Should be involved. The commission was not invited, was not involved, and I understand the negotiations——

Senator McCONNELL. Is that the reason you weren't there because you weren't invited?

Mr. HEMAN. It's my understanding—yes, that's why we were not there. If we'd been invited to be there, we would have been.

Senator McCONNELL. But you were aware that they were going on?

Mr. HEMAN. I'm not sure that we were aware that they were going on. We just—we didn't receive any information along those lines. We also indicated that REA should possibly be invited to be an observer, or whatever the word would be.

Senator McCONNELL. How much contact does the public service commission have with REA?

Mr. HEMAN. With regard to this matter, I attended some meetings about a year ago that had been referred to this morning, I was there simply as an observer, when the merger was first discussed. Recently, we have had no contacts with REA. I was not involved in the negotiations and so forth, I was there as a, again as a presence I suppose or in case any questions were asked as to procedure, commission law, and so forth.

Senator McCONNELL. Well, have you communicated to them that you would like to see the debt restructured?

Mr. HEMAN. No; the last contact I—at that time it's been a year ago, Senator—a part of the scenario, as they say, was that there was going to be a restructuring of the debt, and then that fell by the wayside as you've heard this morning, and as you know. And so, as I say, there's been no recent communication by the commission to the REA, but at the time of the discussions back then that was to be done.

Senator McCONNELL. Let me ask you about the previous rate cases before the PSC dealing with Big Rivers. Did the Federal Government intervene in any of those cases? And if so——

Mr. HEMAN. No, sir. No, sir.

Senator McCONNELL. Did not. REA indicated to my office several months back that the Federal Government has the right to preempt decisions of the public service commission. Do you agree with that?

Mr. HEMAN. No, we would not. I understand there may be some dicta in a court case along those lines, but the commission would contest that and we would assert that the Kentucky PSC has—would have jurisdiction.

Senator McCONNELL. How many rate increases have the customers of Big Rivers received over the past 10 years?

Mr. HEMAN. I may have to get back with you. On the past 10 years? I'm sure that the number of rate cases that all the utilities have had, that there probably have been several, but could I specifically respond in writing as to the amount and the dates of those increase in 10 years?

Senator McCONNELL. Do you remember when the last one was, the last increase?

Mr. HEMAN. Probably the early 1980's, but I do not have that in my memory right now, and I would rather look it up. It's been several years, perhaps 4 or 5 years.

Senator MCCONNELL. There's been a lot of discussion this morning about whether or not the foreclosure action impedes selling off of power or selling part of the system. What's your opinion about that?

Mr. HEMAN. I would think that it would impede to some extent. I don't know what the obligation of the REA to move with this foreclosure suit.

Senator MCCONNELL. Well, they don't appear to be moving with it, they just appear to be letting it hang there.

Mr. HEMAN. It's there and it's hanging, it's been there for a long time, it's in limbo as, I think, Mr. Holbrook indicated with motions flying everywhere, but I would think that it would not be—help them. I think Big Rivers, as someone said, yes, it got their attention. I think they have been aggressively trying to sell power over the last 2 or 3 years, and perhaps this did increase that effort.

Senator MCCONNELL. They've only hired somebody on a contingent fee basis since the foreclosure though, right?

Mr. HEMAN. True. Since April. I think that was—that's true.

Senator MCCONNELL. Any other observations, Mr. Heman?

Mr. HEMAN. No, I would just be repetitive. Obviously I would hope that you and everyone knows that it is just a matter of worry and concern to the commission. We recognize—it's a dilemma situation, we recognize the importance of the aluminum industry to this part of the State, the economy, and all of the services that are involved, and the necessity of finding some solution. I think all of these things have been mentioned to you, and we want to do, and continue to look at what we're doing to see if we're doing enough or whether we should perhaps make some codex, we'll think about that. But, as I said, it's very important. I really appreciate your interest in the matter and I would hope, as I say I personally am disappointed in the REA attitude or whatever. I think it just leaves something to be desired. I think we need some restructuring of that debt to help these people get out of this dilemma, or whatever solution, the alternatives that that may open up.

Senator MCCONNELL. Well, I think it's safe to say in conclusion that, with a possible exception of the sluggish coal business this is the biggest problem in western Kentucky. Everything else pales in comparison to it, and one of the things that I've been trying to do—I think this hearing gives me a further vehicle with which to do it—is to make a point to REA that this is not going to go away, that their failure to show up today is not going to be helpful at all. It lends absolutely nothing to the process for them to avoid this public hearing, and in effect avoiding facing the people of this area of Kentucky with whom they have an opportunity to play a major role as a constructive partner, or as someone who continues to practice a "we versus them" approach to the whole thing and force the system into foreclosure which I think in the judgment of actually everyone here benefits clearly no one. It seems to me there may be some question as to whether they—allowing the foreclosure to hang there may or may not have been an additional impetus at

Big Rivers, but it clearly seems to me that all of those additional actions are now being taken.

It seems to me that the continued hanging of the foreclosure over Big Rivers does nothing but make it less likely that sales can be consummated, either of the power, or the system, or part of the system. So I think the principal thing that I am going to be dealing with Hunter and Naylor about later this week is to justify for me exactly what is being contributed to this problem in a positive manner by allowing the foreclosure suit to continue to hang there. I haven't heard a single word from anyone here today that convinces me that that's a helpful part of solving this problem.

I want to thank all of you for coming out. I think this is exactly what we needed to do in this area of the country to further focus attention on this problem, and I assure you that I am going to continue to spend a major portion of my time on trying to arrive at a solution that's going to benefit the two aluminum companies and the 70,000 residential users in this area. And there's no way, as President Reagan said about the terrorists, they can run but they can't hide. That's the way I feel about REA, they can run but they can't hide. We intend to continue to pound on them, and I am going to pound on them every week from now until they become a constructive part of the solution to this problem.

I want to thank you all for coming out and joining with us in this public discussion that I know the ratepayers in this area are quite interested in. That concludes the Senate Agriculture Committee hearing.

Let me just say there are two staff members here that I do want to introduce from Congressman Carroll Hubbard, who has been very interested in this problem, Beverly Hooper and Mary Lee Lawton. We're glad that you all came out. Thank you for sitting in.

That concludes our hearing.

[Whereupon, at 12:30 p.m., the committee adjourned, subject to call of the Chair.]

APPENDIX

[The following material was inserted by Senator McConnell:]

U.S. Department of Agriculture,
Office of Inspector General,
Washington, D.C, September 5, 1985

Subject: Audit of Big Rivers Electric Corporation
Henderson, Kentucky

To: Harold Hunter
Administrator
Rural Electrification Administration

We have completed our limited scope audit of selected aspects of administrative operations at Big Rivers Electric Corporation (BREC), Henderson, Kentucky. Our review was performed at the request of Congressman Carroll Hubbard. We expanded our audit to review other matters, as we deemed necessary.

Our reviews included tests of costs in such areas as: advertising; employee salaries; insurance; legal services; public relations; and travel. We also evaluated the procedures used by BREC to procure insurance coverage for its facilities, and coal supplies for its generating plants. Our review covered the period January 1979 through December 1984, with emphasis on the period subsequent to BREC's default on its rural Electrification Administration (REA) loan, which occurred in November 1984. We conducted our audit in accordance with generally accepted government auditing standards applicable to the limited scope of our review.

For the period January 1979 through December 1984, BREC reported administrative expenses totaling about $35 million. Of this amount, approximately $23 million represented the premiums paid for insurance coverage, and $3 million was for legal fees. Our review found that these expenses were generally reasonable and customary for an electric utility of the size and scope of BREC. Through analyses of BREC's financial records and supporting documentation, we determined that the expenditures we tested were proper and adequately justified. Nothing of significance came to our attention to cause us to believe that irregularities existed in any untested areas.

During our review, we noted the BREC had initiated several cost-cutting measures as a result of its financial difficulties. These included, among others, the elimination of wage increases for its salaried employees, reduced civic and charitable contributions, and the elimination of all travel not related to the sale of power. Further, BREC has also taken steps to reduce coal inventories and scale back current and planned construction projects. BREC officials have also pursued the sale of excess power to other utilities. To date, these sales have generally been short-term; however, long-term contracts for large blocks of power were being negotiated during our audit.

We discussed the results of our review with the Deputy Assistant Administrator, Electric, on August 14, 1985. Since our audit did not disclose any matters requiring corrective actions we consider the audit closed upon release. We appreciate the assistance provided to the auditors by your staff and the staff of BREC during the audit.

DONN E. ADKISSON,
Assistant Inspector General for Audit.

U.S. General Accounting Office,
Regional Office,
Cincinnati, Ohio, September 16, 1985.

Mr. William H. Thorpe
General Manager
Big Rivers Electric Corporation
P.O. Box 24
Henderson, KY 42420

Dear Mr. Thorpe:

Enclosed, per your request, is a copy of the document summarizing the results of our work at Big Rivers. The document was the basis of our briefing to Congressman Hubbard on August 6, 1985.

We appreciate all you did to facilitate our work at Big Rivers and the cooperation of you and your staff. Let us know if you have any questions regarding the briefing document or the results of our work.

Sincerely,

J. P. Carroll,
Regional Manager.

Enclosure.

U.S. General Accounting Office
Washington, D.C., August 6, 1985

The Honorable Carroll Hubbard
House of Representatives

Dear Mr. Hubbard:

We have completed our examination of the default by the Big Rivers Electric Corporation of Rural Electrification Administration (REA) loans that responds to your February 14, 1985, request. In that letter you asked us to obtain information in four areas related to the Big Rivers situation and assess REA's actions to date. Related to our work, you also requested that the Inspector General of the Department of Agriculture audit the administrative costs incurred by Big Rivers as well as other matters of interest to you. It is our understanding that the Inspector General's office will be reporting the results of its work to you at a later date. As agreed with your staff, we will be briefing you on the results of our work on August 6, 1985.

The attached briefing document summarizes the information we obtained including our observation the REA's actions appear to reflect its overall policy that borrowers are responsible for the operation of their power systems. A question could be raised on the appropriateness of this policy when viewed in light of the Big Rivers situation. However, an evaluation of its appropriateness would require an examination of a broader spectrum of borrowers and projects.

The information contained in the briefing document was obtained through discussions with REA, Big Rivers, and the Kentucky Public Service Commission officials and a review of pertinent documents, records, and procedures of these organizations. The document also contains observations on the Big Rivers situation based on information obtained during this review and past work we have done on the electric utility industry.

Should you desire additional information on our work, please contact Paul Grace, Group Director, of my staff on 252-1400.

Sincerely,

J. Dexter Peach,
Director.

Attachment.

GAO Briefing Document

INFORMATION ON THE DEFAULT BY THE BIG RIVERS ELECTRIC CORPORATION ON REA LOANS—INFORMATION OBTAINED AT THE REQUEST OF CONGRESSMAN HUBBARD

In response to Congressman Hubbard's letter of February 14, 1985, we obtained information on the Big Rivers Electric Corporation (Big River) default on Rural Electrification Administration (REA) loan commitments and specifically Big Rivers' decision to construct the D. B. Wilson plant.

Big Rivers is a generation and transmission rural electric cooperative located in western Kentucky and is responsible for supplying all the electric power requirements of four member electric cooperatives. The Big Rivers' power system serves about 74,000 customers including two large industrial customers. In 1980, Big Rivers began the development and construction of two 395 megawatt coal-fired steam generating plants referred to as the D.B. Wilson units 1 and 2. REA guaranteed a Federal Financing Bank loan of about $1.1 billion for the construction of these units. Construction on D.B. Wilson unit 1 has been essentially completed and plans to construct unit 2 were indefinitely deferred in April 1981. At the end of 1984, planning and construction costs associated with the two units totaled about $790 million.

A summary of the information obtained follows.

I. The events that led to the current situation, including REA's basis for making the loan and Big Rivers' justification for building the plant.

The default by Big Rivers on November 23, 1984, on out-standing REA loan commitments occurred because Big Rivers could not meet its financial obligations to REA. The default occurred on REA loan commitments to Big Rivers which were made prior to constructing Big Rivers' D. B. Wilson plant number 1 (Wilson plant).

Big Rivers' decision to build the Wilson plant was generally based on its projections of increasing electricity load growth in the rural sector, potential new synfuel industrial loads in the mid-to-late 1980's, and its desire to provide adequate reserves for reliable service within its power system.

REA's decision to approve the loan was based on information provided by Big Rivers that included a 1977 Power Requirements Study, a consultant's report on power supply reliability for Big Rivers, and a Power Cost Study. On the basis of Big Rivers information, REA prepared a power planning analysis, concurred in Big Rivers' decision to construct to plant, and approved the loan.

After construction of the Wilson plants had begun, Big Rivers experienced continued declines in its rural electric load growth, plans to build the synfuel plants were cancelled, and Big Rivers was unable to sell the Wilson plant or its power. Subsequently, Big Rivers defaulted on its financial obligations to REA.

II. REA's actions to oversee the loan and keep abreast of the situation.

REA's policy concerning its relationship with borrowers specifies that borrowers are responsible for the efficient and effective management of their affairs, including proper and successful construction and operation or their power systems. REA has internal procedures for generally monitoring borrowers' power needs and for identifying and assisting borrowers undergoing situations that may endanger the security of loans.

With respect to the Big Rivers loan for the Wilson plants, REA, according to its procedures, was to review and approve power requirements studies by Big Rivers. REA reviewed and approved Big Rivers' 1977 power requirements study, but did not take action on or approve Big Rivers' 1980 or subsequent studies. We also noted that REA has no established procedures to assess decisions made by borrowers to continue, cancel, or defer construction on plants being financed by REA loans or loan guarantees. However, an REA official told us REA was aware of Big River's decision in 1981 to indefinitely defer its plans to construct Wilson unit 2 and continue construction on Wilson unit 1 and that REA agreed with Big Rivers' decision.

With respect to REA procedures to identify and assist borrowers undergoing situations that may endanger the security of loans, REA identified Big Rivers as such a borrower pursuant to its Instruction 100-4 around August 1984 when Big Rivers informed REA that it might not be able to continue making payments on its loans. REA did not, however, prepare a plan for corrective action as provided for in its procedures but rather made the decision to foreclose on Big Rivers' outstanding loans.

III. Wilson plant decisions made by Big Rivers throughout the loan period, including its assessment of the plant's impact on consumer electricity rates.

Throughout the loan period, Big Rivers made a number of decisions related to the construction and operation of the Wilson plants 1 and 2. The first was in August 1981 when Big Rivers decided to indefinitely defer all engineering work on Wilson plant 2. In October 1981 Big Rivers decided to continue constructing Wilson unit 1 because (1) it continued to project a need for additional power in 1986, (2) the cost to cancel the plant was estimated at about $300 million, (3) it believed a 1- or 2-year construction delay would cost about $86 and $96 million per year, respectively, and (4) it believed the power from the plant could be marketed.

In April 1984 Big Rivers filed an application with the Kentucky Public Service Commission for two alternate rates that were related to a sale/leaseback of the Wilson plant and a deferred cost recovery proposal. Under either proposal, Big Rivers expected to recover the costs of the Wilson plant. In October 1984 Big Rivers withdrew its rate proposal application because it believed National Southwire Aluminum Company and Arco Metals, two of its major industrial customers, would close their plants it the rate increase were granted.

In November 1984 Big Rivers diverted debt service proceeds to pay Wilson plant construction contractors because REA refused to advance any additional loan funds to Big Rivers. Big Rivers then filed suit against REA for release of further loan funds. This suit is still pending. In January 1985 REA notified Big Rivers that it was in default. In April 1985 Big Rivers agreed to merge with East Kentucky Power Cooperative under conditions laid out in a Bechtel study of a possible merger. However, REA, through the Department of Justice, refused to accept the merger as proposed because of the potential financial burden to be assumed by the government under the proposal.

As of July 1985, no costs associated with the construction of the Wilson plant have been approved by the Kentucky Public Service Commission to be included in electricity rates charged to Big Rivers customers. At the time Big Rivers justified the construction of Wilson plants 1 and 2, the cost in mile per kilowatt hour (kwh) was estimated to rise to around 90 in 1995 from a 1980 level of 24. According to the loan guarantee commitment recommendation by the REA staff to REA's Administrator, the rate increases were supported by Big Rivers member distribution cooperatives and by the local economy of the areas served.

IV. REA's actions to date to protect the government's interest, particularly REA's proposal to merge Big Rivers. What other alternatives has REA considered?

To protect the government's interest in loans provided to Big Rivers, REA filed a foreclosure lawsuit against Big Rivers in January 1985 subsequent to being informed by Big Rivers that it would be unable to make payments on REA loan funds.

Prior to the foreclosure action, REA had informed Big Rivers that Big Rivers should advise REA of the actions it intended to take to resolve its financial problems. Big Rivers responded by informing REA that it intended to continue its efforts to sell power from the Wilson plant. REA also asked Big Rivers in November 1984 to submit evidence of the economic feasibility of its system to pay off its debts. We found no evidence that Big Rivers provided such evidence. Further, REA suggested that one alternative to resolving its problems could be a merger or consolidation. Since the foreclosure action, REA rejected, in June 1985, a specific merger proposal as discussed above.

General Observations

On the basis of information obtained and our overall knowledge of the electric utility industry, we have the following additional observations.

-- The Big Rivers power system is not typical in that the major share of its electric power (about 70 percent) is sold to two major industrial customers (aluminum companies).

-- Declining loan growth experienced by Big Rivers in the late 1970's and early 1980's was generally experienced by the electric utility industry.

-- Many utilities made decisions to cancel, delay, or defer construction of generating plants during this time period, which resulted in substantial unanticipated costs to utilities.

-- REA's role, actions, and general posture throughout the loan period reflected its policy that borrowers are responsible for the operation of their power systems.

-- The final disposition of the Big Rivers situation will depend on the extent to which power can be sold from the Wilson plant at rates sufficient to recover operating and construction costs or the plant itself can be sold.

STATEMENT OF HON. HAROLD V. HUNTER, ADMINISTRATOR RURAL ELECTRIFICATION ADMINISTRATION

Mr. Chairman, the Department of Agriculture and the Rural Electrification Administration appreciate this opportunity to submit testimony regarding Big Rivers Electric Corporation. We are well aware of the significant concerns you and your constituents have in this matter. You and your staff are to be commended for taking a leading role in the search for a positive resolution to the problems confronting Big Rivers.

We regret our inability to be with you today, but as you know, there are currently legal proceedings pending between the government and Big Rivers. Therefore, we have been advised by counsel that it would be inappropriate for us to testify in person before your committee today.

For many months now, the Department of Agriculture and the Rural Electrification Administration have been working with all interested parties to find a solution to the financial problems of Big Rivers. These efforts, of course, have been without prejudice to our right to proceed to foreclose on Big Rivers for its failure to pay its debts to the United States. But, we all are looking for a resolution to the problem that would be in the best interests of the government, the American taxpayers, Big Rivers, its distribution members and the retail consumers.

Any number of factors have led us to the point where we are today, and we agree with you that there is little to gain by pointing fingers of blame. Rather we must all work together and move forward.

To this end, the government will continue to cooperate with the management of Big Rivers, the other lenders and other interested parties in exploring potential remedies. It is too early to speculate on whether a solution will be found, or if it is, on the precise nature of any specific remedy. But, we hope a solution will be found and that it will involve the participation of all parties.

Once again, Mr. Chairman, we commend you for your interest and leadership in this matter. Thank you.

STATEMENT OF WILLIAM F. KLAUSING
SENIOR VICE PRESIDENT, IRVING TRUST CO., NEW YORK, NY

Good morning, Senator McConnell. My name is William Klausing; I am Senior Vice President in charge of the Public Utilities Division of Irving Trust Company in New York City. Before I begin my testimony I would like to express the Bank's appreciation of the opportunity to participate in these hearings. The issues being discussed today are important and warrant the attention they are receiving from the financial community, consumers, the Administration and Congress.

I would like to address several matters: First, what is Irving Trust's interest in this matter? And second, what is being done and what else can be done with respect to Big Rivers and the consumers it serves in Kentucky?

Irving Trust has long been one of the nation's leading banks in lending to the public utility industry. While we have had a history of lending to investor-owned utilities, as a private institution we have not been able to compete with the government in lending to the rural electric system. We, therefore, have been supportive of the Administration in encouraging rural electric cooperatives to seek access to private banking and capital markets.

One such instance involves Big Rivers Electric Corporation. Ohio County, Kentucky, issued pollution control bonds to provide funds to pay for pollution control equipment to be used by Big Rivers in connection with its Wilson Power Plant. Because Ohio County issued the bonds, they were tax exempt. If the tax-exempt financing had not been made available that the scrubbers would have been built with REA funds that had been set aside for this purpose. The funds from the bonds merely replaced the REA funds, thus lowering the debt cost to Big Rivers.

The ability to raise money from such bonds, and the marketability of those instruments, turns, obviously, on the confidence investors have that the bonds' principal and interest payments will be met. In this case, institutional investors were not familiar with Ohio County or Big Rivers. So in 1983, Irving Trust increased investor confidence by issuing a standby letter of credit to assure payment of the bonds' principal and interest. The bonds have been marketed -- and, at times, remarketed -- on the strength of the Irving Trust letter of credit. Irving Trust receives a fee of 5/8 of 1% per year for providing this letter of credit. For this fee we assume the credit risk associated with the bonds. A rate of 5/8 of 1% is, of course, much lower than one would expect if one looked at the financial statements of either Big Rivers or Ohio Country. But we entered the deal knowing that the plant was nearly complete, REA funded, and that there had never been a bankruptcy by a rural electric cooperative.

Irving Trust thus viewed with serious concern the situation that developed at Big Rivers, leading to the Government's decision to commence a foreclosure proceeding. Foreclosure would not only put Irving Trust at risk as a creditor, but could be symptomatic of a growing problem affecting electric cooperatives generally. We were concerned about the effect a foreclosure proceeding would have on rural electric co-ops nationwide and the ability of the rural electrification system to continue to meet its obligations and to obtain financing in the future.

Let me now turn to what steps we have taken. To be frank, our first reaction upon hearing that the government was in court seeking a foreclosure was to consider our own litigation alternatives, including intervention in the foreclosure action or quick negotiation to get the best deal and then getting out. We did none of these things. Rather, in recognition of a common interest in finding an economically sensible solution, our approach has been to try to see if some common ground can be found among the interested parties.

Thus Irving Trust undertook to open lines of communication among the business people and policy-makers at the Government, Big Rivers and the banks. We net with both Government and Big Rivers executives and are pleased to report that we were not the only ones with concerns and with a desire to work out a viable solution.

Representatives of the Department of Agriculture and Big Rivers agreed to explore in depth the possibility of developing a full body of information and of identifying viable economic alternatives for Big Rivers, as opposed to resorting to lawsuits involving foreclosure and creditors' rights.

An agreement was reached to see what the economic alternatives for Big Rivers were so as to ensure a continued source of affordable power for the system's customers. A Working Group was established, which included bankers experienced in financing, loan work-outs and restructuring, representatives of the United States Department of Agriculture, of which the Rural Electrification Administration is a part, and officials of Big Rivers, who understand the problems which that entity faces. We deliberately set the group up as a business committee, not a lawyers' committee, because we wanted to explore business solutions in a free and candid atmosphere.

The Working Group moved into action immediately, and I think that it already has accomplished a great deal, even though it clearly has far to go. It has examined the economics of Big Rivers and of the industry. Among the issues being explored are: off-system power sales, transmission problems, management of the company's reliance on aluminum smelters, expense controls, existing coal contracts, sale of Wilson (in whole or in part), sale of other Big Rivers generating plants, real estate sales, and mergers.

The banks and the Government agreed to share the costs of retaining one of the lending consulting firms in the energy field, ICF, to examine Big Rivers. Big Rivers, as part of its effort to solve its problems, has retained a Pittsburgh-based marketing/consulting firm that specializes in energy matters to assist in the effort to locate and negotiate off-system power sales. Negotiations have already commenced with several utilities, and proposals are expected from others. The point is that the Working Group is considering an array of alternatives. In our opinion all of the parties are taking a long-range view. We all understand that the problems facing Big Rivers will not be solved this week, this month, or even this year, and we all understand that the goal is to assure the long-term economic viability of the Big Rivers system.

This may well involve short-term, off-system power sales to provide revenue to enable Big Rivers to survive until the demand for electricity in western Kentucky has caught up with supply. We know this may take five, seven or even ten years. It may be that the answer is even longer-term power sales, which would enable Big Rivers to survive and continue to serve the people of Kentucky even if demand for electricity does not increase. The key, as we see it, is to examine each and every alternative, and that is precisely what we are doing.

Where do we go from here? What else can or should be done? It seems to me we have some answers, but not all of them. It, therefore, is critical that the Working Group be allowed to continue its efforts and that Big Rivers not be diverted from that task. The Government and the banks, including Irving Trust, have an enormous financial stake in the success of Big Rivers. While the total bank exposure is about $150 million, the government position is approximately $1.1 billion. That gives us all an incentive to try to find the best way to make Big Rivers viable and economically successful. Big Rivers is a cooperative composed of several member utilities, all of which would like to survive, be economically viable and serve their customers and constituencies. All are interested in the success of the Working Group and its investigation. Precisely because of the ways in which the interests of the banks, the Government and Big Rivers converge -- and yet also diverge -- I think we will arrive at a consensus that will ultimately reflect the best interests of the people of Kentucky and the users of the Big Rivers system.

We have met with counsel for the KPSC to offer our assurance that we will keep the KPSC informed of our actions. Obviously, the Commission must act in accordance with its rules and procedures, but we think it is important for the

Commission to know what the Working Group is doing. We hope that, if only informally, the Commission will advise us if we are on the wrong track or overlooking something of great importance. I think it is important, though, to let this Working Group continue, to let ICF finish its work and submit its recommendations, and to let the consultants try to identify alternative revenue sources to help Big Rivers through its current difficulties. Irving Trust believes that to halt or divert the efforts of the Working Group at this time would constitute a grave injustice to Big Rivers, to the customers of Big Rivers, and to the people of Kentucky.

We also believe that it is important for Congress to oversee federal policies affecting entities such as Big Rivers. We know that Congress recognized the importance of the Rural Electrification Administration and the rural electrification system. The actions of Congress to ensure continued funding of REA demonstrates a continued commitment to the system. As you might imagine, the uncertainty posed by bankruptcy and foreclosure proceedings has significantly limited cooperatives' access to credit markets. However, we believe that things are now on the right track and heading in the right direction. We think we are playing an active and constructive role in coming up with a viable economic solution to Big Rivers' problems.

Thank you very much, Senator.

STATEMENT OF WILLIAM H. THORPE, GENERAL MANAGER
BIG RIVERS ELECTRIC CORPORATION

Senator McConnell, as general manager of Big Rivers Electric Corporation, I welcome you and your committee to Henderson. We at Big Rivers appreciate your personal interest and thank you for being here today.

We recently had the benefit of audits by the General Accounting Office by the Inspector General. We cooperated fully in those audits, and we welcome this additional opportunity to present the facts to you and to the public.

Big Rivers is a not-for-profit generation and transmission cooperative (G&T) serving more than 73,200 consumer-members in 22 western Kentucky counties. These consumers buy their power directly from one of our four distribution cooperative members: Green River Electric Corporation at Owensboro; Henderson-Union Rural Electric Cooperative Corporation at Paducah; and Meade County Rural Electric Cooperative Corporation at Brandenburg.

Big Rivers was formed to provide cheap power to the farms and homes of western Kentucky, and to bring industry to this area. Both objectives were achieved in two decades. Nearly 100% of our rural members now have low-cost electricity. This low-cost power attracted major aluminum, paper, chemical and other industries which provide thousands of high-paying jobs. Our unusually large industrial load makes Big Rivers the second largest G&T in the United States in power sales, which reached 9.4 billion kilowatt hours in 1984.

Like many other electric utilities all over the country, Big Rivers has fallen on hard times. This results chiefly from conditions largely beyond our control, including:

(1) An unprecedented decline in the growth of electric demand, locally and nationally.

(2) Unanticipated and continued low, worldwide aluminum prices.

(3) The long time necessary to acquire a site, and to design, permit, and construct a generating plant which requires the matching of supply and demand approximately eight years in the future.

These conditions hit Big Rivers concurrently in the midst of its construction of the D. B. Wilson Station. We cancelled Unit 2, but were too far along to cancel Unit 1, which has been completed and is now operating for testing purposes. The target we were aiming at in 1977 has moved. We now have generating capacity beyond the immediate needs of our members, and we are not able to pay all of our debts at the present time.

Our consumers, creditors, employees, and the general public have vital stakes in the solution of Big Rivers' financial problems. We at Big Rivers believe that aggressive sales of power from the Big Rivers system, coupled with determined cost reductions, best serve all interested parties, and for more than two years we have vigorously pushed both long- and short-term power sales and cost reductions. These efforts are beginning to bear fruit.

We have consummated a ten-year contract for the sale of 54 megawatts (MW) of power to the Municipal Energy Agency of Mississippi (MEAM), and we are now selling power under that contract.

We have signed a contract to sell power to Alabama Municipal Electric Association (AMEA) for 15 years, 65 MW in 1986, increasing to 82 MW on January 1, 1987, and to 109 MW on January 1, 1988 and thereafter. We are now working with AMEA on certain contract changes changes suggested by the Rural Electrification Administration (REA).

Big Rivers has signed letters of intent for power sales contracts with municipal and cooperative utilities in four states east of the Mississippi River. These possible sales vary from 75 MW to 410 MW. We have good prospects to sell all of the power generated by the Big Rivers system, including Wilson Unit 1.

To augment our own sales efforts, on April 12 of this year we obtained the highly qualified services of Russell, Rea, & Zappala, Inc., of Pittsburgh as sales agents who will be paid a commission only on sales they make.

Big Rivers' major financial backers, the REA and Irving Trust Company and Manufacturers Hanover Trust Company, have employed ICF Corporation, financial consultants, to study our needs and to make recommendations. We are working closely with all of these firms.

We have not neglected other opportunities.

At REA's request, we attempted to merge with East Kentucky Power Cooperative Inc., Our sister G&T in Winchester, Kentucky. The directors of both cooperatives voted to merge upon terms outlined in a study by Bechtel Energy Corporation. REA, through the Justice Department, notified us on June 3, 1985 that this merger proposal was unacceptable. On August 22 REA notified East Kentucky and Big Rivers that they should keep their options open, and that REA would communicate with them at a later date. We will carefully consider any such communication immediately on its receipt.

An outright sale of the Wilson Plant, or interests in it, is another course we have unsuccessfully attempted with two G&Ts and other utilities.

Our directors also approved negotiations to sell the entire Big Rivers' system. We have talked and are continuing to talk to other utilities about this possibility. The danger of a shutdown of National-Southwire's aluminum smelter at Hawesville is a major hindrance to such a sale. NSA's critical problem is the worldwide decline in aluminum prices, rather than its power costs. Neither NSA's power costs nor the power costs of Big Rivers' other consumers have increased since January of 1981. Indeed, they are lower today than they were a year ago. We are sensitive to NSA's competitive needs, but our ability to help is limited by our financial straits and by our obligations to all of our consumers and creditors.

Our efforts to sell long- or short-term power, the Wilson plant or interests in it, or the entire Big Rivers system have been hindered by the pending suit to foreclose a mortgage on Big Rivers' assets, and by the possibility of reorganization under Chapter 11 of the U.S. Bankruptcy Code. Some prospective buyers are hesitant to negotiate with us in these circumstances, thinking that a better buy might be made later at a foreclosure sale, or that power contracts with us might be set aside in bankruptcy. Big Rivers fully intends to meet its obligations to its consumers and its creditors, and it will continue to fight a courthouse sale or bankruptcy.

In November 1984, REA declined to advance loan funds previously approved for Wilson Unit 1. This forced Big Rivers to use its revenues to complete the unit, and to default in payments it would have made otherwise to REA. Now that this work is nearly completed, and Unit 1 is operating, we have resumed payments to REA, and have paid it approximately $20 million since May.

We are making progress with our cost-reduction program. Fuel costs are approximately one-half of our total costs. Big Rivers has made significant reductions in these costs by renegotiating major coal contracts. These saving are passed directly to Big Rivers' consumers through the fuel adjustment clause of its tariff.

Our overall coal costs are approximately $29 per ton, and they will soon be even less. Big Rivers' coal cost is less now than during last year. The Department of Energy Publication, "Electric Power Quarterly", shows that for the first quarter of 1985, the latest information available, Big Rivers had the lowest average as-burned coal cost in cents per million British Thermal Units (BTU) of any utility in Kentucky, and the second lowest cost of all utilities in Kentucky, Indiana, Illinois, Ohio and Tennessee.

We believe that by the time this hearing is held we will have revised three major coal contracts to give Big rivers one of the lowest costs per million BTU of any utility in the entire Midwest.

The average cost of coal delivered to our plants from September 1984 through August 1985 was $30.08 per ton, or 135.83 cents per million BTU. The cost in 1986, including an allowance for inflation, is projected to be $28.37 per ton, or 132 cents per million BTU. This means that an estimated $7.8 million will go directly to our consumers through lower energy rates; it will provide nothing for payment on Big Rivers' debts.

Capital cost -- the cost of our generating and transmission facilities -- is our second largest cost. We have reduced this cost through the cooperation of Ohio County, Kentucky, and Irving Trust Company and Manufacturers Hanover Trust Company by borrowing the proceeds of $141,300,000 of tax-free pollution control bonds at interest rates of 6 to 7-1/4%. By the time of this hearing, we hope to have achieved a further cost reduction by refunding $82,500,000 of the Ohio County pollution control bonds to reduce the annual interest rate from 7-1/4% on that issue to approximately 5-7/8% per annum. The remainder of our debt is owed to the United States, and the cost of this capital is beyond our control, short of reorganization in bankruptcy.

Despite these hard times in the utility industry, we are optimistic. The Wilson Station will become a great asset. At a time when sites for generating stations are increasingly hard to obtain, the Wilson Station has room for four additional generating units of the size of Unit 1. This site is located on Green River, and thus has access to the greatest inland waterways system in the world. It is in the middle of one of the world's largest bituminous coal reserves. Wilson Generating Unit No. 1 is capable of producing upward to 440 megawatts gross. We are now selling a substantial part of that power to TVA at test-power prices. Unit 1 is equipped with state-or-the-art pollution control facilities and thus affords a market for Western Kentucky's low-cost, high-sulphur coal, as well as protection against acid rain legislation. While the cost of this unit is high compared to older units, the cost of units constructed from now on will be even higher. The demand for electricity will soon surpass the supply, and we will then have a cheap and reliable supply. Our present costs are substantially lower than those of many utilities, particularly to the north and east of us, and to whom we could supply power at a profit if we had adequate transmission lines interconnecting us. Senator McConnell, you and your colleagues could help us by enacting legislation to expedite the construction of such transmission facilities.

We have taken other measures to hold down costs. While some of these are painful, they are relatively insignificant in solving our financial problems. They include:

- 323 salaried employees have not received an annual pay increase since July 1984, and none is budgeted for the next fiscal year.
- No additions to employee benefits have been made since July 1984.
- All but the most essential travel has been eliminated.
- Training programs and seminars for employees have been restricted to those required to meet certain state or federal certification requirements.
- Inventories have been reduced to a minimum level.
- We have deferred construction and system improvement projects that do not now gravely affect our ability to serve our loads.
- We have not replaced employees who have secured other employment.
- We have eliminated all charitable contributions.

We cannot tell you now when we will solve our financial problems, but solve them we will. We believe we are on the right track in continuing our efforts to sell power and to reduce costs. We welcome your suggestions.

With your help and the cooperation and help of our employees, the REA, the aluminum smelters, the Public Service Commission, the banks, and our consumer members, we can and will succeed.

I will attempt to answer -- or to provide answers to -- any questions you may have.

Thank you.

STATEMENT OF DONALD R. NORRIS, PRESIDENT AND GENERAL MANAGER EAST KENTUCKY POWER COOPERATIVE, INC.

Question 1. Please state your name and address.

Answer: Donald R. Norris, 202 Delaplain Road, Winchester, Kentucky 40391.

Question 2. By whom are you employed and and in what position.

Answer: I am President and General Manager of East Kentucky Power Cooperative, Inc. (East Kentucky Power), headquartered in Winchester, Kentucky.

Question 3. How long have you held that position?

Answer: Since February 4, 1980.

Question 4. What is your employment history prior to your employment at East Kentucky Power?

Answer: From 1949 to 1953, I was employed by Brown Engineering Co., a consulting engineering firm in Des Moines, Iowa. Our clients were rural electric cooperatives, municipal power supply systems and investor owned utilities within the state of Iowa. My duties and responsibilities included long range engineering planning, project feasibility studies, system adequacy studies, facility design, preparation of plans and specifications for transmission and distribution construction projects, and resident engineer duties related to supervision of line construction for various transmission and distribution projects. From 1953 to 1957, I was System Engineer for Greene County Rural Electric Cooperative of Jefferson, Iowa. My responsibilities were general distribution engineering duties plus advising member-consumers on efficient utilization of electricity, on adequate electrical wiring, and on proper selection of equipment. From 1957 to 1980, I was employed by Eastern Iowa Light & Power Cooperative, Wilton, Iowa; as Transmission Engineer from 1957 to 1964; as Assistant General Manager from 1964 to 1971; and as General Manager and Chief Executive Officer from 1971 to 1980. As General Manager, I was responsible for overall cooperative operations including short and long range planning for needed generation, transmission, and distribution facilities, and short and long range financial planning including the submission of needed rate adjustment cases to the Iowa State Commerce Commission.

Question 5. What is your educational background?

Answer: I received a B.S. Degree in Electrical Engineering from Iowa State University at Ames, Iowa, in 1949. Since that time, and during my work career, I have attended numerous management, engineering and financial seminars and institutes conducted by Iowa State University, the University of Iowa, the National Rural Utilities Cooperative Finance Corporation (CFA), the National Rural Electric Cooperative Association (NRECA) and the Rural Electrification Administration (REA).

Question 6. Could you please list any business or civic organizations of which you have been a member.

Answer: During my career I have served on several state and national committees regarding rural electrification. From 1977 to 1980 I was a member of the Board of Directors of the National Rural Utilities Cooperative Finance Corporation (CFC) in Washington, D.C. While on the CFC Board, I served on the Loan Committee for two (2) years, on the Finance Advisory Committee one (1) year, as Vice-President of the Board of Directors and Chairman of the Operating Review Committee for one (1) year, and as President of the Board of Directors one (1) year, 1979-1980.

Question 7. Mr. Norris, please provide a brief background description of East Kentucky Power.

Answer: East Kentucky Power is a generation and transmission rural electric cooperative which serves eighteen (18) member distribution cooperatives in central and eastern Kentucky. These member distribution cooperatives serve over 280,000 consumer members most of which are residential customers in the 89 Kentucky counties we serve. East Kentucky Power currently has 1305 MW of net generating capacity from three generating stations located near Ford, Burnside and Maysville, Kentucky. Additionally, East Kentucky Power receives an allocation of 170 MW of peaking capacity from the Southeastern Power Administration and is a member of the

Kentucky-Indiana Power Pool along with Kentucky Utilities, Public Service Company of Indiana, and Indianapolis Power and Light. We also have a 600 MW generating station, the J.K. Smith Station, under construction in Clark County, Kentucky.

Question 8. Do East Kentucky Power member cooperatives serve areas close to those served by Big Rivers Electric Corporation (Big Rivers)?

Answer: Yes, in fact our member cooperative service areas are contiguous in Grayson, Hardin and Bullitt counties in Kentucky.

Question 9. Does East Kentucky Power have an interconnection agreement with Big Rivers?

Answer: Although our members' service areas are contiguous in certain areas, East Kentucky Power and Big Rivers have no interconnected transmission facilities. We currently have an interconnection agreement effectuated through a three party agreement with Kentucky Utilities Company. The power transactions through this agreement are limited to the surplus capacity in the Kentucky Utilities transmission line as determined by Kentucky Utilities.

Question 10. How did East Kentucky Power first become involved in discussions of a merger or consolidation with Big Rivers?

Answer: The concept of such a merger of consolidation between East Kentucky Power and Big Rivers was first mentioned to me during discussions with REA Southeast Area officials in late 1984 concerning our most recent Power Supply Study and the preparation of a financing plan for the J.K. Smith Station. After the concept was raised, Mr. William Thorpe, General Manager of Big Rivers, and I met with REA officials in Washington, at their request, to discuss the idea further.

Question 11. Then the concept of an East Kentucky Power/Big Rivers merger or consolidation has been examined by East Kentucky Power as one possible way to resolve issues relating to the future of the J.K. Smith project?

Answer: That is correct. East Kentucky Power has consistently maintained that such a reorganization could be a viable alternative as long as the results of such merger would be as beneficial to our member consumers as those we could achieve independently.

Question 12. Could you please give a brief history of the J.K. Smith Station project.

Answer: East Kentucky Power began planning for the construction of a power plant with two 600 MW generators in the late 1970s based on the conclusions of 1986 and 1979 Power Requirements Studies which forecast a doubling of energy requirements during the 1980s and a generating capacity deficiency as early as the 1983-84 winter season. A certificate of Environmental Compatibility along with financing authority was granted to East Kentucky Power for this project on December 19, 1980 by the Kentucky Energy Regulatory Commission, (now the Public Service Commission), following nearly nine months of review and four hearings.

Construction of the project began in early 1981, following a January 12, 1981 Commitment Notice from the REA for a $1,011,352,000 loan for Unit 1, common facilities for two units, and related transmission facilities. At that time, commercial operation of Unit 1 was scheduled for January 1985, with Unit 2 to follow approximately one year later. However, due to revised load forecasts, which indicated a significant reduction in load growth, the commercial operation date of Unit 1 was, in September 1981, deferred until October 1987 and Unit 2 was placed on indefinite deferral. A decision to cancel Unit 2 of the project was made in June, 1982, after a new 20 year load forecast showed a further slowing of load growth, and in December, 1982, the commercial operation date of Unit 1 was deferred until October, 1992.

Currently J.K. Smith Station Unit 1 is approximately 13% complete with minimal construction now on-going, but with substantial construction activity scheduled to resume in late 1987 to achieve the 1992 commercial operation date. The REA loan commitment for the project expires in January 1988.

Question 13. Please briefly outline East Kentucky Power's early activities regarding study and approval of the Big Rivers merger or consolidation proposal.

Answer: East Kentucky Power began evaluations of the proposal immediately after it was raised by REA representatives in late 1984. We considered the proposal to be of critical importance to the future plans of East Kentucky Power and took steps to provide information to, and obtain input from, all department of the cooperative as early as December, 1984. Specific responsibilities were assigned to staff members from the areas of finance, planning and legal. Personnel from other areas were utilized as needed. We began in intensive effort to resolve many basic questions about the feasibility of a merger or consolidation and to focus on the steps which would need to be taken to accomplish it.

It was obvious to us from the first serious discussions of such a proposal that the assistance of an outside consultant would be required in order for a thorough examination of the feasibility of such an undertaking to be made in a reasonably short period of time. Once it was agreed by both East Kentucky Power and Big Rivers, and reviewed by REA, Bechtel Energy Corporation was retained to prepare an organizational alternatives study to determine the best course of action. After having assembled some preliminary information, Bechtel presented a formal work plan and schedule on December 27, 1984, and began working with us and Big Rivers to assemble all relevant information right after the first of the year.

Question 14. East Kentucky Power and Big Rivers both approved a so-called Memorandum of Understanding (the "Memorandum") regarding merger or consolidation in early 1985. Please explain the background of that agreement.

Answer: REA had ceased advancing loan funds to Big Rivers in November of 1984 and had requested board resolutions from Big Rivers and East Kentucky Power which approved the merger of the two cooperatives before additional funds would be advanced. Big Rivers had passed such a resolution on November 21, 1984. Before East Kentucky Power could consider such a resolution, we felt that the basic terms of the merger had to be outlined. With the assistance of CFC, we began evaluating such terms in January of 1985.

As I have previously mentioned, East Kentucky Power has consistently stated that for merger or consolidation with Big Rivers to be acceptable to us, the terms would have to be at least as beneficial to our consumers as actions we could take on our own. We have been concerned for some time about actions which need to be taken to provide for the timely completion and financing of the J.K. Smith project. East Kentucky Power has taken steps on its own to reduce the eventual cost of the plant by ceasing to capitalize construction interest costs and by paying such interest costs from margins for the past two years. We are pleased to have been able to accomplish that, as a result of highly favorable off-system sales, without increasing our rates to our member cooperatives. Our wholesale rate to them has not changed since April 1, 1983 and is now approximately 45 mills per kwh. Prior to the initial discussions on merger, we had done a substantial amount of analysis on the best way to proceed on financing the J.K. Smith project and had reached certain tentative conclusions. The plan which was emerging from that analysis then became the measure against which merger of consolidation was compared.

East Kentucky Power had determined that its best course of action, on its own, was to continue to utilize margins to reduce costs, begin phasing projects costs into its rates gradually, and to aggressively attempt to market the sale of 200 MW of the plant capacity. Following such a plan seems to be the best of several alternatives which avoid a tremendous sudden increase in rates in 1992 and 1993 which would occur if costs are not phased in gradually.

The purpose of the Memorandum was to define the conditions which must be met to make merger or consolidation of the two cooperatives feasible and comparable to East Kentucky Power's other options. Many of those conditions were loosely defined at that point and could not be made more definite until the Bechtel Study was completed. These conditions related to such factors as state Public Service Commission approval of the plan and adequate wholesale rates, the continued existence of Big Rivers aluminum loans, and REA's commitment to take certain actions deemed critical to the survival of a merged cooperative. These commitments included advancement of operating funds to Big Rivers on an interim basis, allocation of loan funds to finance transmission facilities to interconnect the two cooperatives, and the purchase of an amount of preferred stock of the combined cooperative adequate to reduce capital costs by $35 million annually. REA and the Public Service Commission would also have to agree to the deferred scheduling and financing of the J.K. Smith Station. The Memorandum also contained certain basic terms regarding the consolidation of the cooperatives.

The general form and content of the Memorandum was approved by East Kentucky Power, subject to further detail revisions, on January 23, 1985, at a special board meeting. The board of directors specified at that time that the Bechtel Study should be restructured along the terms of the Memorandum and directed that the study proceed as quickly as practical. A special merger committee, consisting of the chairmen of the three standing committees of the board of directors and its Executive Committee, was also formed at that meeting to monitor and expedite the study.

Question 15. What transpired after that time?

Answer: The Bechtel Study progressed and many of the necessary conditions of the Memorandum were brought into closer focus. Our staff continued the examination of the multitude of technical, financial and legal questions surrounding the merger of two cooperatives. After further weeks of study, Bechtel presented its draft working paper on March 25, 1985, which included a preliminary evaluation that merger of the cooperatives, based on criteria contained in a scenario identified as Case 6, appeared to be the best of the several alternatives studied. On April 12, 1985, Big Rivers' board of directors voted to approve consolidation with East Kentucky Power under the provisions of Case 6.

During the following weeks, East Kentucky Power personnel worked closely with Bechtel representatives in an attempt to solidify the conclusions of the study and to make necessary revisions to the Memorandum. The most significant revision, based upon the results of the Bechtel Study, was an increase in the amount of preferred stock which REA would need to agree to purchase. Rather than a $35 million annual capital cost reduction, the purchase of preferred stock would have to result in a $70 million annual cost reduction to make the merger feasible. Other detail changes were made and a copy of the final Memorandum, as executed, is attached hereto as Exhibit "A". The East Kentucky Power board approved the final Memorandum on May 14, 1985, and Big Rivers' board approved it on May 17, 1985.

Question 16. What response did REA make to the Memorandum?

Answer: In a letter dated June 3, 1985, Mr. Morton Holbrook, attorney for Big Rivers, Mr. James G. Bruen, Jr., Special Litigation Counsel for the Justice Department, representing REA, stated that the plan of merger set out in the Memorandum was unacceptable and indicated that this was due to the size of the preferred stock purchase by the Government which was contemplated therein. The $70 million reduction referenced in the Memorandum would have required a purchase of approximately $600 million in preferred stock considering the interest rates on existing REA loans.

Question 17. Did East Kentucky Power take any further actions regarding the merger proposal after that rejection of the memorandum.

Answer: Yes we did. Based on conversations with officials of REA and the Justice Department, we were concerned that perhaps certain provisions of the Memorandum were being misinterpreted or that the implications of certain terms were not being fully understood. For that reason, and at the suggestion of Mr. Bruen, we prepared a letter in which we sought to present our interpretation of the terms of the Memorandum and to explain the intent of certain terms. A copy of said letter is attached hereto as Exhibit "B".

Question 18. What was the reaction to that letter?

Answer: While various officials expressed their thanks for our efforts, the last communication which we have received on this subject from the government is a letter from Harold Hunter, Administrator of REA, asking us to keep our options open until mid-September, when they would contact us. To date, we have had a few telephone conversations with REA officials, but no contact as contemplated in said letter.

Question 19. What is East Kentucky Power's present position regarding merger with Big Rivers?

Answer: As Mr. Hunter requested, we have kept our options open. We consider the merger plan represented by the Memorandum to be a viable alternative for East Kentucky Power. However, we see no room for significant further negotiation of terms since the Memorandum terms represent the minimum that East Kentucky Power must have in order to be as well off as we can be under our own plans.

Question 20. Where does East Kentucky Power intend to go with its financing plan for the J.K. Smith Station?

Answer: With the apparent failure of the merger plan, East Kentucky Power has turned its focus to dealing with the rapidly-approaching problem of the J.K. Smith Station financing. We must begin to implement our phase-in of construction costs soon in order to minimize the large rate increases which we would otherwise face. (However, a major complication in this process is the uncertainty as to REA's agreement to extend our existing loan commitment.) The unforeseen decline in our load growth since this project was begun has stretched our construction schedule well past the expiration of the loan commitment. These delays have also added significantly to the projected cost of the plant and could, potentially, require nus to seek additional loan funds. East Kentucky Power is committed to putting the J.K. Smith Station on line at the proper time and is willing to take the necessary actions to minimize both the costs of the project and the impact on our consumers. To do this we will need REA's cooperation and support.

Question 21. So what's East Kentucky Power's next step?

Answer: I will recommend to our board that we seek an extension of our existing loan commitment until 1996, and then accelerate our efforts to effectuate the most feasible and practical plan for our consumers, which may or may not include implementation of the proposed consolidation.

Question 22. Are you prepared at this time to say if and when Smith Station will be completed?

Answer: I believe we must have a definite recommendation in the next two or possibly three years. Of course, that decision will be affected materially by what actions the REA and the Kentucky Public Service Commission may choose to take in the interim. I cannot overemphasize, however, that whatever course of action is ultimately taken, East Kentucky

Power must continue to address its immediate and pressing needs now, and as I stated before, REA's continued cooperation and support will be required during this entire process.

Question 23. Does that conclude your prepared testimony?
Answer: Yes it does.

[EXHIBIT A]

MEMORANDUM OF UNDERSTANDING BETWEEN EAST KENTUCKY POWER COOPERATIVE, INC. AND BIG RIVERS ELECTRIC CORPORATION

BIG RIVERS ELECTRIC CORPORATION ("BREC") currently faces substantial economic difficulties which are the result, in large part, of insufficient market demand for the electric generating capacity created by the completion of its Wilson Station; and, EAST KENTUCKY POWER COOPERATIVE, INC. ("EKPC") may face similar economic difficulties in the future as a consequence of electrical loan growth lower than anticipated and the prospective costs associated with completion of construction of its Smith Station. In view of these economic conditions, both current and prospective, it appears to be in the interests of BREC and EKPC, their respective member distribution rural electric cooperatives and the customers of those distribution cooperatives to combine the resources of BREC and EKPC.

To that end, the Boards of Directors of BREC and EKPC, hereby declare their mutual intentions to enter into a definitive agreement of consolidation (the "Agreement") which will contain, among other things, those provisions hereinafter specified and pursuant to which BREC and EKPC will consolidate and will be succeeded by a consolidated corporation to be names COMMONWEALTH POWER COOPERATIVE, INC. ("CPC"). The consolidation to be accomplished pursuant to the Agreement shall be subject to such prior approvals as may be required by law or by the provisions of this instrument.

The consolidation to be accomplished pursuant to the Agreement shall be subject to the prior satisfaction of each and all of the following conditions:

> (1) The Public Service Commission of Kentucky ("PSC") shall have granted to CPC or to its constituent corporations, with the intention that such grant shall apply to CPC, rate increases adequate to ensure the economic feasibility of consolidation; and, except with respect to certain rates pertaining to aluminum smelter Contract Demands to be separately negotiated and discussed in (2) below, such rate increases, initially, be in the following approximate amounts:
>
> (a) Within areas currently served by EKPC -- a rate increase over EKPC's wholesale power rates existing as of the date of this Memorandum,

which shall represent the phase-in of interest during construction of Smith Station; and

(b) Within areas currently served by BREC -- a sufficient increase to provide for wholesale rate levels equivalent to those prevailing in the areas currently served by EKPC.

(2) Contracts, in form and substance satisfactory to counsel for BREC and EKPC and approved by the federal Rural Electrification Administration ("REA"), PSC and the respective Boards of Directors of both BREC and EKPC, shall ave been negotiated and executed which will provide for the continued existence for CPC of the aluminum smelter Contract Demands currently contracted for by certain of BREC's member distribution cooperatives, at rates ensuring the economic feasibility of consolidation, with performance of those contracts by the operators of the National-Southwire Aluminum Co. and Alcan Aluminum Ltd. smelters assured by guarantees of the respective ultimate parent corporations of those operating entities or by other means deemed adequate by counsel to BREC and EKPC.

(3) In form and by documents deemed adequate by counsel to BREC and EKPC, REA shall have made the following commitments to CPC or to its constituent corporations with the intention that such commitments will apply to CPC:

(a) Agreement to purchase from CPC shares of preferred stock to be issued by it (the "Preferred Stock") in an amount and with sufficient dividend rate as will result in an annual reduction in CPC's current capital costs of approximately $70 million; and the exact amount and terms and conditions of the Preferred Stock, including a redemption option exercisable by CPC in the event of certain favorable developments in volume of sales from Wilson Station, shall be determined by and shall be acceptable to counsel for BREC and EKPC;

(b) Consummation of a loan to BREC, at 5% annual interest, of funds sufficient to meet any current revenue short-fall sustained by BREC pending consummation of the consolidation contemplated by the Agreement;

(c) Agreement, on terms and conditions acceptable to counsel for BREC and EKPC, necessary, after full utilization of the existing transmission facilities of BREC and EKPC, to construct transmission facilities required to interconnect the existing systems of BREC and EKPC; that amount being currently estimated to be $65 million (in 1985 dollars);

(d) Agreement, in form and substance satisfactory to BREC and EKPC, to the extension of financing to support a deferred construction schedule for completion of EKPC's Smith Station which shall include appropriate guarantee commitments and a commitment to the phase-in of interest during construction of Smith Station to improve the economic feasibility of the Smith Station; and

(e) Approval of use of the sinking fund method of depreciation for purposes of accounting procedures applicable to the Wilson Station;

(f) Release of any and all previously approved loan funds to BREC, dismissal of the action styled United States of America v. Big Rivers Electric Corporation, Civ. No. C85-0012-O(J) currently pending in the United States District Court for the Western District of Kentucky, and reinstatement of all REA loans to BREC under their respective terms and conditions.

(g) Agreement to use all reasonable efforts to facilitate and cooperate with CPC in the sale of power on a wholesale basis by CPC to third parties, within or without the Commonwealth of Kentucky, as permitted by applicable Kentucky law, in order to reduce the unused proportion of CPC's existing and projected generating capacity.

(4) Consummation of a contract, and approval by REA, for the sale of 54 MW of firm capacity of Wilson Station to the Municipal Energy Agency of Mississippi for a ten-year period at a demand rate of $11.55/kw/mo.

(5) Procurement from any entity or governmental agency of the necessary approvals and consents to the Agreement, the consolidation thereby contemplated and any and all transactions connected therewith (including the issuance of Preferred Stock).

As used hereinabove, PSC approval shall mean approval by final order not subsequently reversed or modified in judicial proceedings.

The Agreement shall, in addition to customary covenants, warranties and representations and other provisions which are customary or desired or which are required by applicable law, contain the following terms and conditions:

1. Provision for planned rate increases by CPC in subsequent years reflecting the phase-in of interest during construction of Smith Station. Subject to applicable provisions of Kentucky law, CPC's By-Laws and wholesale power contracts which CPC shall make with its members or to which it shall succeed, the planned increases in rates for such period shall be determined by the Board of Directors of CPC on an annual basis and shall be based on the projected financial operation of CPC.

2. Provision allocating revenues from sales of kw capacity from Wilson Station in excess of those subject to current commitments ("Additional Wilson Capacity Sales") as follows:

(a) 50% of the revenue from Additional Wilson CapacitySales shall be used to redeem and retire the Preferred Stock; and

(b) the remaining 50% of the revenue from Additional Wilson Capacity Sales shall be used and applied to reduce or to eliminate planned CPC rate increases which would be necessary absent such Additional Wilson Capacity Sales.

3. Provision or provisions that the chief executive officer of CPC shall be the chief executive officer of EKPC on the effective date of the consolidation and that the chief executive officer of BREC on the effective date of consolidation shall serve as the manager of the "western division" of CPC, reporting directly to the chief executive officer of CPC.

4. The Board of Directors of CPC will consist of one representative and one alternate of each of the members of EKPC, and one member and two alternates of each of the members of BREC, until such time as the terms of the current Board members of BREC expire. At that time, all member systems of CPC will have one Board member and one alternate on the CPC Board. At all times each member system of CPC will have one vote.

5. Provision or provisions that all of the employees of CPC shall be treated fairly while recognizing the differences the presently exist between the employment relationships of EKPC and BREC and their employees.

6. Provision pursuant to which Articles of Consolidation, substantially in the form attached hereto as Exhibit A, shall be adopted as the basic corporate document of and for CPC, subject to necessary approvals.

7. Provision pursuant to which BREC and EKPC each agree to use their best efforts to obtain any consents, required or desirable to be obtained to the transfer of any contract, agreement, lease or other undertaking to which BREC or EKPC is party or by which the assets of BREC or EKPC are bound, which, as a matter of law is deemed to occur upon and as a result of consolidation.

8. Provision that the Boards of Directors and, where appropriate, the staffs of both of BREC and EKPC will jointly prepare and support any and all petitions or applications to the PSC and to any other regulatory or administrative body (including without limitation the federal Internal Revenue Service) pertaining to approval of the consolidation contemplated by the Agreement, proposed rate increases, a determination of federal tax status and any and all other matters necessary for or appropriate to consolidation on the terms and conditions contemplated by this Memorandum of Understanding.

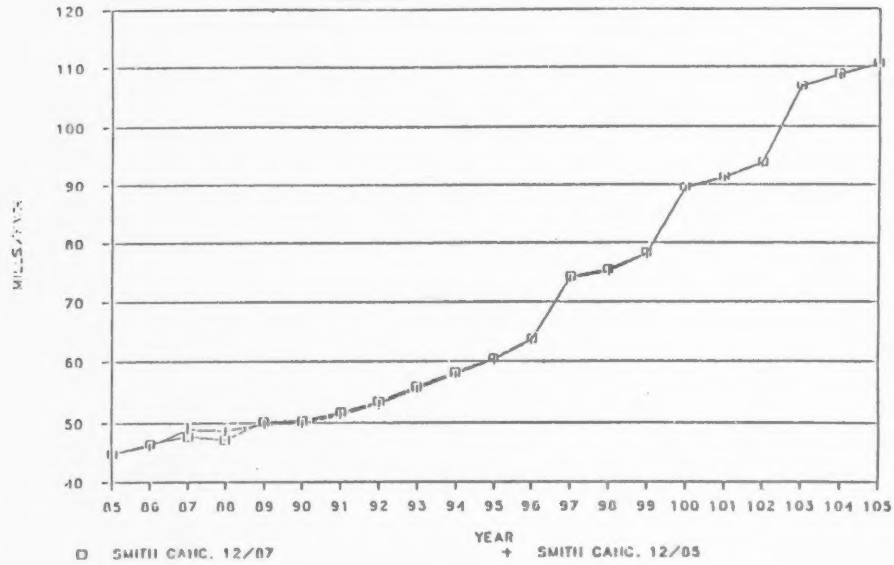
9. Provision that BREC and EKPC will each pursue the consolidation contemplated by this Memorandum of Understanding diligently and in good faith but that, notwithstanding the foregoing termination of the Agreement due to the failure

by either BREC or EKPC, acting in good faith, to obtain consent of tis members or of any administrative or regulatory agency required by law or to obtain any agreement listed herein as a condition precedent or termination of negotiations concerning the Agreement due to the failure, despite good-faith bargaining by each of BREC and EKPC, to consummate an Agreement the material provisions of which are satisfactory to BREC and EKPC, shall be without liability of BREC to EKPC or liability of EKPC to BREC.

IN WITNESS WHEREOF, the Boards of Directors of each of BREC and EKPC have caused an appropriate corporate officer to set his respective hand to this Memorandum of Understanding this _______ day of May, 1985.

President Big Rivers Electric Corporation	Chairman East Kentucky Power Cooperative, Inc.

EKP MEMBER WHOLESALE POWER COSTS



EKP MEMBER WHOLESALE POWER COSTS

MILLS/KWH 7/09/85

	SMITH CANC. 12/87	SMITH CANC. 12/85
1986	46.54	46.19
1987	47.83	49.06
1988	47.27	48.77
1989	50.23	49.85
1990	50.38	50.01
1991	51.74	51.39
1992	53.47	53.13
1993	55.88	55.55
1994	58.16	57.84
1995	60.53	60.22
1996	63.76	63.46
1997	74.24	73.95
1998	75.44	75.16
1999	78.27	78.00
2000	89.68	89.42
2001	91.44	91.19
2002	93.93	93.69
2003	106.78	106.54
2004	108.78	108.55
2005	110.58	110.35

[EXHIBIT B]

July 22, 1985.

James G. Bruen, Jr., Esquire
Special Litigation Counsel
Commercial Litigation Branch
Civil Division
Department of Justice
550 Eleventh Street, N.W.
Washington, D.C. 20044

Dear Gerry:

Re: EKP/BR Memorandum of Understanding

Pursuant to our conversation last week, I have attempted to summarize and explain, as succinctly as I believe practical, the major or most significant provisions of the Memorandum of Understanding ("Memorandum"; a copy is enclosed for your ready reference), previously submitted to the REA.

By way of introduction, let me say that, from East Kentucky Power's (EKP) standpoint, we have attempted to prepare a document that would not impact our member cooperatives' ratepayers significantly differently than if EKP were not a party or participant to the proposed consolidation and proceeded to finance and construct the Smith Station Unit I by the scheduled completion date of October, 1992.

The Boards of Directors of EKP and Big Rivers (BR) have agreed to enter into a definitive consolidation agreement in accordance with the provisions of the aforesaid Memorandum, subject to certain prior conditions, which include (1) the Public Service Commission of Kentucky's (PSC) approval of rates as described at page 2, paragraph (1) (a), (b) of the Memorandum; (2) the execution of contracts, approved by the various interested parties, with the affected aluminum companies containing appropriate rates and guarantees as described at page 2, paragraph (2) of the Memorandum. Prior to EKP and BR attempting to satisfy the aforesaid conditions, REA must appropriately commit to a number of provisions as shown on pages 3 and 4 of the Memorandum. Of those provisions, I believe that only three of them [3 (a), (c) and (d) at page 3] necessitate or dictate further explanation or elaboration.

The most significant, and certainly the most discussed and possibly misunderstood, of these three provisions is the one related to the sale of preferred stock. The Bechtel study projects that a merged EKP/BR system would encounter a minimum revenue shortfall of approximately $70 million a year for the first several years, when compared to revenue levels which could be achieved by EKP operating on its own. Bechtel recommends that debt with the purchase of a like amount of preferred stock by REA. While the details of such a purchase could affect the amount of preferred stock needed to achieve such a capital cost reduction, Bechtel estimates that a purchase of $600 million in preferred stock will be needed, based on an 11% cost of debt.

In Case R4 of Appendix D to the study, Bechtel presents a debt restructuring plan which provides that dividends, set at the Kentucky statutory maximum of 4% per annum, will not be payable until 1991, and that all preferred stock will be redeemed by 2005. While the terms and conditions of such a preferred stock purchase need not match this plan exactly, EKP believes that a plan resembling Case R4 will adequately address the crucial issue of this revenue shortfall while providing a schedule for the timely redemption of the preferred stock. ELP estimates that REA's maximum potential financial exposure under such a purchase, due to loss of interest, would amount to approximately $379 million.

This financial exposure, in all probability, will be substantially reduced by the effect of Item 2 on page 5 of the Memorandum which provides that 50% of any capacity sales revenue from Wilson Station, in excess of the 54 MW commitment to MEAM, will be paid to REA for the early redemption of preferred stock, over and above any set dividend and redemption schedule agreed to by REA, EKP and BR.

The next provision, relating to a $65 million transmission loan, is fairly straightforward. It should be understood that we may not need this transmission facility if we are able to amend and expand our existing contractual commitments with Kentucky Utilities (KU). prudent business practice dictates, if not necessitates, however, that we be in a position to finance the necessary transmission facilities between EKP and BR in the event we are unable to negotiate successfully with KU.

The third provision, 3 (d), deals with REA's consent to the extension of financing for the deferred construction schedule for J.K. Smith Station and approval of EKP's plans to begin the phase-in of Smith interest during construction (IDC). REA approval of the extension of financing is needed due to the expiration of the 7-year period for Smith loan drawdowns in 1988, some four years prior to the current commercial operation date. Despite REA's historical opposition to the concept of expensing IDC, EKP believes the phase-in of Smith IDC to be essential to either a merged or independent operation, and the phase-in of Smith IDC is assumed in Bechtel's analysis.

An additional comment concerning the timing on the decision of whether or not to cancel Smith Station Unit I might also be appropriate. It is EKP's opinion that a final decision on Unit I's fate should be delayed until about December, 1987, because of the relatively small increase in costs as compared to canceling it this year. Enclosed is a chart prepared by our Engineering Division which depicts our members' wholesale power costs if the Smith Unit is canceled in December, 1985, and December, 1987. There is a difference, but as you can see, it is practically deminimus. Certainly, sound and prudent business practices dictate that under the uncertain and volatile conditions of the utility industry, it would be worth the additional costs to see if we can't find a market for that power in the next two years. EKP is committed to vigorously seek out such a market and, especially with REA's assistance, we are fairly confident that we can find such a market for all, or at least a substantial portion of it.

Gerry, I trust that this letter will help clarify the Memorandum, at least to the point where you and your people will want to get together with us and explore this proposal further. I believe that EKP's efforts alone, aside from the merits of the proposal, justify that consideration. Obviously, I don't know the specifics of the other options available to your client, but I do know that this proposal has considerable merit for all principal parties involved, and I believe it warrants careful consideration.

I will leave further distribution of this letter to your discretion. I will anxiously await hearing from you. Thank you again for all the time and consideration you've given this matter.

Very truly yours,

EAST KENTUCKY POWER COOPERATIVE, INC.
Foster J. Collis, General Counsel.

STATEMENT OF HAROLD WAYNE NEWTON
COUNTY ATTORNEY, HANCOCK COUNTY, KENTUCKY

My name is Harold Wayne Newton; I am the County Attorney of Hancock County; I was born and raised in Hancock County, and have lived there all my life except for seven (7) years when I attended college and law school.

I also practice law on a part-time basis in Hancock County, and my law practice and position as County Attorney allows me to gain first hand knowledge of the people and economy of Hancock County.

I have an important stake in the well-being of Hancock County.

I see an awful threat to the well-being of Hancock County, and I want to give you a brief outline of the importance of this crisis to Hancock County.

When I left Hancock County in 1961 to go to college, Hancock County was a rural farming county which, like many, or most counties in Kentucky, offered scarce career or job opportunities to young people. Most young people had to leave the county for employment elsewhere.

In 1968, when I returned to Hancock County to practice law, National-Southwire Aluminum came to Hancock County, and NSA and some other industries that located there reversed the direction of Hancock County; it remains a rural county with all the advantages of a small, friendly community that is a good place to raise a family.

But it also became a good place for employment.

NSA and its companion plant, Southwire, employ near 1,100 people;

The annual payroll at this complex exceeds $27 million; this $27 million is pumped through the economies of Hancock, Daviess, Ohio and other surrounding counties. In Hancock County alone, one or more of the breadwinners of 300 families are employed at NSA and Southwire.

Big Rivers is also an important part of Hancock County's economy; Big Rivers has a generating plant in Hancock County, and it employs about 130 people. The generating plant, the Coleman Station, inevitably has its fortunes tied to NSA and Southwire. The "domino theory" of disaster surely applies here. If NSA fails, so will Coleman.

Let me highlight the benefits that Hancock County receives from NSA and also from Big Rivers' presence:

In addition to the $27 million payroll of NSA, Big Rivers' Coleman employees are paid over $4 million annually;

NSA paid over $151,000.00 in utility taxes to our school system last year -- NSA paid over $30,000.00 in other taxes last year -- NSA's employees paid $272,000.00 in occupational taxes last year.

Being a former county judge/executive, you can appreciate the disastrous effect of having over 20% of the county budget suddenly disappear.

Big Rivers paid over $60,000.00 in property taxes to Hancock County last year, and its employees paid over $42,000.00 in occupational taxes to the county. Together, NSA and Big Rivers paid over 20% of the locally generated tax revenue of Hancock County.

These tax dollars have helped make Hancock County a very progressive county, where excellent services are available to our citizens.

School System:	One of the best in Kentucky-modern buildings, above average pay for teachers.
Park System:	Hancock County has one of the best park and recreational systems in Kentucky.
Ambulance Service:	Trained EMTs, up-to-date equipment.
Road System:	One of the best.
Sheriff's Office:	Police protection around the clock, with dispatchers on duty 24 hours per day.
Contributions To:	Senior Citizens programs, Rescue Squad, Volunteer Fire Departments, Efforts to provide water system to rural areas, etc.

But NSA means more than jobs and taxes -- NSA has helped bring a better way of life to us. NSA has been a good neighbor, an asset to our community.

NSA built an airport in Hancock County, and anyone can use it.

NSA allows its employees time to respond to civic needs.

Three of the five members of the Hancock County School Board are NSA employees -- two of four members of the Hancock County Fiscal Court are NSA employees.

These people probably would not even live in Hancock County but for NSA -- they would have left us years ago to seek employment elsewhere, except that NSA's presence permits them to live in the community where they were born and raised.

This "Good Life" that Hancock County now employs is in peril; we are about to lose the benefits provided by the presence of NSA and Big Rivers' Coleman plant.

Everyone agrees that NSA cannot survive unless either current aluminum prices soar or electric rates plunge to a level that NSA can compete in the market place.

It is also quite apparent that if NSA fails, Big Rivers' Coleman Plant would probably have to close, and it is likely that the entire Big Rivers system, as it exists today, would either fail or undergo very drastic changes. One of those changes would be skyrocketing electric rates for 71,000 consumers in Western Kentucky.

But as my prime concern is for Hancock County, I will let others address that problem.

WHAT DOES THIS PRESENT CRISIS PORTEND FOR HANCOCK COUNTY?

Several months ago, someone with a flair for descriptive phraseology said that if NSA fails, it would be like setting off an atomic bomb in Western Kentucky. If that is the case, the very epicenter of that bomb blast would be in Hancock County.

If NSA fails, over 300 Hancock Counties would immediately lose their jobs; then scores more would suffer the same fate because of the "ripple" effect.

Probably several hundred Big Rivers' employees would lose their jobs.

Jobbers, suppliers, and other people in support industries would be out of work.

The County's budget would be devastated; the immediate loss would be over 20% of the budget. The "ripple" effect would enlarge the loss. County government would have to curtail or even discontinue the services now provided to the people.

The School System's budget would be dealt a terrible blow. The loss to the school system would amount to over $200,000.00, according to some informed estimates. In a small system as Hancock County, this loss would drop us from a high level to a subsistence level.

These are measurable losses. What we cannot measure today is the loss that Hancock County will suffer to its progress, its spirit, its optimism, to its people's right to the pursuit of happiness that America provides for us.

We can't measure the losses of bankruptcies, home foreclosures, debt defaults, that will follow NSA's closing.

We can't measure the sorrows and pains that will accompany the dismantling of Hancock County that will follow on the heels of NSA's closing -- but we can imagine that it will be of tremendous proportions.

Senator, I don't have a solution; I'm just a small town country lawyer that has been a primary beneficiary of the benefits brought to Hancock County by NSA and our other industries and I know first hand what it will be like to lose them.

I do know that there is a solution somewhere if the able people present can come up with it.

On behalf of Hancock County, its School System, and its 8,000 citizens, I want to:

(1) Ask you and REA, and others who are present to remember the people of Hancock County whose jobs and well-being hang in the balance, depending on how this crisis ends.

(2) Urge you to use your position and your contacts to help us.

(3) Thank you for your concern and your expressed willingness to help solve this dilemma.

STATEMENT OF PAUL BELANGER, PLANT MANAGER
SEBREE ALUMINUM SMELTER, ALCAN ALUMINUM CORPORATION

Good morning, Senator McConnell. My name is Paul Balanger. I am the Plant Manager of the Alcan aluminum smelter located off the Pennyrile Parkway near Sebree.

Alcan wishes to thank you, Senator McConnell, and the Senate Agriculture Committee for coming to Henderson today and giving us an opportunity to testify on this important matter.

The Alcan Aluminum Corporation Plant at Sebree consumes large quantities of electricity. Total electrical costs at our plant accounts for about 38 percent of our costs.

We estimate that our power costs are 45 percent higher than the average power costs of other U.S. aluminum producers. I would like to point out that a number of competing aluminum companies have requested substantial rate reductions (e.g., Alumax, National Southwire, Noranda, etc.). In the Pacific Northwest, the Bonneville Power Administration recently granted rate relief to the largest concentration of smelters in the U.S. in recognition of the dire straits in which the aluminum industry finds itself today.

Other aluminum companies have curtailed high power cost aluminum reduction facilities (e.g., Alcoa in New York and Indiana; Reynolds in Arkansas; and Noranda in Missouri). Over the last few years, all aluminum smelters located in the Tennessee Valley Authority service area have been permanently closed with the exception of those which had long-term preferred power contracts. The permanent closure of high power cost facilities, of course, has reduced the average power costs of the U.S. smelters which continue to operate (estimate 20-21 Mills).

The average price of power at foreign aluminum smelters is approximately 17 Mills. This low cost, along with the positive effect which the strong U.S. dollar is having on foreign smelters' other production costs, is placing our domestic aluminum smelters in great jeopardy.

During the Big Rivers Rate Case, we proposed consideration of an agreement to index the price Alcan pays for power to the price of aluminum. We were aware of such arrangements in Australia and elsewhere. Some discussion had also been taking place with the smelters in the Pacific Northwest. Our proposal was for two years and provided for lower power rates as long as aluminum prices remained below a benchmark price. As the price of metal increased, the Alcan power rates would have increased until we had funded any deficit built up during the low rate periods. At the end of the two year term, Alcan agreed to pay Big Rivers (Henderson Union) any underfunding with inputed interest. In other words, Big Rivers was guaranteed revenues equal to what they would have received under the current contract. Big Rivers studied our proposal, expressed a great deal of interest, but no action has been taken.

A second, but entirely separate, issue has been the fact that Big Rivers does not need the Wilson Power Plant. Big Rivers has tried to sell the facility or alternatively enter into long-term power sale contracts.

There may be a misconception that if Big Rivers sells the Wilson Plant, their problems and the aluminum companies' problems are solved. This is not the case. The power rates which we are currently paying are not to include any costs associated with the Wilson Plant. As I have previously stated, those rate are, nevertheless, still well in excess of the U.S. average. With the current rates, we already have curtailed one-third of our production and laid off or terminated 250 employees. I would like to point out that the decision to cut production was made when metal prices were approximately 48 cents on the London Metal Exchange (LME). They have recently fallen to below 43 cents and each cent represents a revenue reduction for the Sebree smelter of approximately $2,500,000 annually at the current production rate.

In April of this year -- over seven months ago, when business conditions in our industry were stronger than they are today, Alcan told the Kentucky Public Service Commission that "we are paying more for electricity in Kentucky than 96 percent of all the smelting capacity in the world." In addition, Alcan witnesses told the Public Service Commission that "these rates put the Sebree smelter in a precarious position and make it a prime candidate for shutdown." We re-emphasize those statements today, because selling the Wilson plant will not give us one penny of relief from our current power rates.

Today's aluminum prices are the lowest they have ever been in real terms. Even the low-cost producers with hydroelectric power are suffering. Almost all aluminum companies reported losses in the third quarter.

Imports have a big effect on the U.S. aluminum market. Many foreign smelters are government owned or subsidized to create jobs or export cheap power in the form of aluminum.

By exporting aluminum in exchange for U.S. dollars, the producing countries improve their balance of payments. With the strong U.S. dollar, many of these producers have actually realized aluminum price increases when the aluminum transactions are converted into their currencies. Meanwhile, the U.S. aluminum companies have seen LME prices fall from about 72 cents in early 1983 to the recent low below 43 cents. Prices have been hovering around 47 cents or 48 cents for nearly a year. The break-even point for most U.S. smelters is believed to be between 54 cents and 60 cents per pound.

Current analysts' projections are that worldwide aluminum inventories must decrease substantially due to further curtailment of primary production for an appreciable price increase to occur. We would prefer to keep running and "wait out" the current severe problem. To do this, power price concessions will be required.

In summary, we would like to reiterate these points:

1. Our power costs are forty-five percent higher than the average power cost of other U.S. smelters.
2. There are many other U.S. aluminum companies which have curtailed production or permanently closed high-cost reduction facilities.
3. In order to remain competitive, we need some variability in the cost of our power.
4. Solving the Wilson plant problem will not improve our current power rates.
5. The aluminum market is worse now than it was six months age, and it does not show any signs of near term improvement.

STATEMENT OF H. GARY SATTERWHITE, VICE PRESIDENT & GENERAL MANAGER, NATIONAL-SOUTHWIRE ALUMINUM CO.

We are pleased that Senator McConnell and the Senate Agricultural Committee are taking an active interest in the Western Kentucky power problem and initiated this hearing to provide a forum to generate potential solutions.

This is a critical time for Western Kentucky and National-Southwire Aluminum Company ("NSA"). The question is: Can we survive this troubled time in the American Aluminum industry and not be forced to consider options that might result in devastating economic effects to all of Western Kentucky and portions of Southern Indiana? The necessary first step is to establish a competitive price for the power which we need to operate our plant, and to make aluminum.

We have been victimized by a combination of low aluminum prices and higher than average energy charges for an aluminum smelter operating in the United States. We presently pay more for electric energy per pound of aluminum produced than any other aluminum producer in the country.

When NSA first came to the Ohio Valley, the total generating capacity of Big Rivers was 70 MW. The contract for the large, steady load which we entered into with Big Rivers allowed them to build the 450 MW Coleman Power Plant and the resulting economics of scale brought all of Big Rivers' customers' rates down. Our added load at that particular time resulted in savings to Big Rivers' power users of over $765,000 per year compared to what they would have paid had we not located in Hancock County. The low-cost Coleman Power was one of the primary incentives that induced us to build our smelter in Kentucky.

Contrary to what happened to electricity rates when the Coleman Plant was brought into production, the construction of the Green Two Plant (which, by the way, was built principally to provide power for the then-Anaconda Smelter at Sebree) caused rates to rise for everyone on the Big Rivers System, including NSA, which is a direct competitor of the Sebree Smelter. The addition of the Green Two Plant resulted in over $24,000,000 per year of added costs to Big Rivers' power users, including over $9,000,000 per year additional costs to NSA alone.

The recently constructed Wilson Power Plant now threatens even higher rates for everyone on the Big Rivers system. The load forecast for future demand on which the Wilson Plant was justified has not materialized. Although the Kentucky Public Service Commission has found that Big Rivers may not compel its ratepayers to pay for the Wilson Power Plant, we are, in fact, paying for it. Big Rivers has vast excess power, even without Wilson, which it is selling, or trying to sell, and crediting the revenues to the Wilson plant. We believe all revenues from the sale of excess power should be credited only to the existing system until the existing system's capacity is fully utilized.

Other aluminum producers, whose power costs have always been significantly lower than NSA's, have recently obtained rate relief, putting NSA at an even greater disadvantage competitively. These other utilities -- which include the Bonneville Power Authority, the Santee Cooper Power Company, and the New York Power Authority -- have obviously recognized the importance of jobs and the benefits afforded them by having a large, steady load as an anchor to their consumer base and have taken measures to ensure their survival. We believe that Big Rivers and REA can and should do this for NSA. Over the past year or so we have offered numerous suggestions that would enable Big Rivers to lower its operating costs and to reduce its rates to NSA. Big Rivers has, in fact, made one proposal to us that would appear to lower our cost of power during periods of weak aluminum prices. This scheme, however, involved borrowings by Big Rivers to cover their deficit, which would have to be repaid with interest by NSA within two years. We have rejected this proposal because we feel that further borrowing to cover excessive power costs is not a solution to excess power costs and high rates and is certainly not in the best interests of the ratepayers.

Basically, we believe Big Rivers should take the same action any company should take that finds itself in an untenable economic situation: They should renegotiate their coal contracts, eliminate all wasteful and unnecessary expenses, restructure their financial obligations and seek to sell additional power in order to add revenue to the present generating system.

We need, at this point, to discuss the concept of declining block rates for power. I believe everyone is familiar with the practice of volume discounts. Most businesses employ the practice of price breaks at certain volume levels -- a tank-car load of gasoline sells for less per gallon than gasoline bought at the service station pump; a truckload of melons sells for less per unit than those sold at the supermarket. The same economies of scale are applicable to the sale and delivery of power. In fact, most power contracts of 10 to 15 years ago included such volume discount features, but such practices fell into disfavor during the energy crisis of the mid-70's. Perhaps some modification of this concept can be applied in order to provide some relief to the aluminum smelting industry in Kentucky.

Big Rivers now finds itself with far more generating capacity than it needs without even counting the Wilson Plant. We feel that Big Rivers would be justified in offering NSA -- and others -- demand price breaks for large blocks of steady load power demand. This incentive demand charge, along with cost reduction efforts such as lower price coal contracts, should allow for rates to NSA in the 22 mill range, which is above the average power rate paid by smelters in the United States.

Other aluminum smelters have closed recently because of high electricity costs -- the Reynolds plants in Arkadelphia and Jones Mills, Arkansas, and the Martin Marietta Smelter in the Dalles, Oregon, for example. If NSA cannot operate economically, the effect will go far beyond the direct loss of jobs and payroll at Hawesville. Big Rivers should consider what it would do if it lost its largest source of revenue; then, both Big Rivers and REA will be in an even worse financial condition than the present one. We at NSA feel that we are doing all that we can to help ourselves. However, we are concerned that Big Rivers has given up and no longer has any intention to devise plans (other than the Australian Plan, which we rejected). (See attached article from Big Rivers' in-house paper.) We have done all the things that we have suggested Big Rivers try:

- We have cut wages and salaries.
- We have reduced staff by 177 people (17 percent).
- We have renegotiated raw material and service contracts.
- We have developed technology changes that will allow us to reduce the amount of electricity we use per unit of aluminum production -- but we will not be able to invest the $15 million dollars required unless we have a competitive power rate.
- We have negotiated in good faith with BREC and REA, with few results to date.

We also feel that REA has a major role and responsibility in this affair. We believe that they should consider some innovative financing options which would include the extension of time for the repayment of loans to Big Rivers on the present generating system. NSA presently pays over $80,000,000 per year for electricity. Should NSA be forced out of business because of these high power rates, then Big Rivers would have to find some way to make up this revenue loss. They would not be able to turn to Southwire Company or to National Aluminum because they are not parties to our contract with Big Rivers. However, I believe that National Aluminum and Southwire would be willing to consider a guaranteed contract if we could be assured of a competitive power rate in the future.

Finally, we recommend that the REA consider accepting a moratorium on the debt payment (both principal and interest) related to the Wilson One Power Station for an indefinite period and to credit all power sales to the existing system for the same period.

One thing we can't do is continue to delay. Time, for us, is running out. We have to have a resolution to this problem now!

[Reprint from Big Rivers In-House Paper]

BIG RIVERS RESPONDS TO NSA'S COMPLAINTS

National Southwire Aluminum at Hawesville has filed a complaint with the Public Service Commission (PSC) and released incorrect information concerning Big Rivers' attempt to lower costs and thereby help the aluminum smelting industry.

NSA's latest contentions include:

The way we assign our intersystem sales. NSA has challenged our allocations and wants us to take a portion of the revenue derived from our intersystem sales credited to the Wilson Plant and instead, credit it to the existing system and lower NSA's rates. We believe our allocations of intersystem sales revenue are fair. They were approved on May 6, 1985, by the PSC in our rate case (No. 9163).

Our coal costs. NSA alleges that we "continue to pay approximately $35 per ton for coal when the true market price is less than $25 per ton." This allegation is grossly misleading. While Big Rivers is purchasing some coal under older contracts at $35 per ton, Big Rivers overall coal costs are approximately $29 per ton, and will soon be less. They also state "notwithstanding NSA's repeated demands, BREC has failed to consummate negotiations to reduce its coal costs." This allegation is also misleading. Big Rivers has renegotiated several contracts to lower coal costs, and the paperwork is under way to amend these contracts.

Big Rivers' coal cost is less now than last year and that did not happen by accident. It is the result or hard work to reduce these costs, a fact which NSA appears to ignore. The Department of Energy publication "Electric Power Quarterly" for the first quarter of 1985, which is the latest information available, shows that Big Rivers had the lowest average burned coal cost in cents per million British Thermal Unit (BTU) of any utility in Kentucky and the second lowest cost of all utilities in Kentucky, Indiana, Illinois, Ohio and Tennessee.

A BTU is a measure of heating value, and the coal purchased by Big Rivers generally has a heating value which varies between 10,000 and 11,500 BTU per pound. By the time this article is in print, as a result of ongoing efforts to renegotiate coal contracts, we should have completed revisions on three major contracts which would lower our costs to one of the lowest costs per million BTU of any utility in the entire Midwest. To say we have not been diligent in lowering our coal costs is not true, and NSA knows better, as they have been continually informed of our progress.

The average cost of coal delivered to our plants from September 1984 through August 1985 was $30.08 per ton, or 135.83 per million BTU. The cost in 1986, including an allowance for inflation, is projected to be $28.37 per ton, or 132 per million BTU. That amounts to an estimated $7,866,000 in lower annual costs which goes directly to all our consumers through lower energy rates as a result of the fuel adjustment clause.

Lowering their power cost to 22 mills. NSA's complaint reads in part, "Moreover, the dual impact of the aforesaid reductions should be applied first to reduce NSA's rate to 22 mills before adjusting the rates of other patrons..." That would mean lowering NSA's power cost more than 21 percent, or over $16 million per year. What they are demanding is that the rates to all other Big Rivers consumers be increased by $16 million per year. What they are demanding is that the rates to all other Big Rivers consumers be increased by $16 million per year while worldwide aluminum prices are down. Neither Big Rivers nor our 72,000 consumer-members can afford to meet the unreasonable demands of NSA. We have during the past several months met with both NSA and Alcan trying to negotiate a mutual solution. The key word is mutual. NSA apparently only finds acceptable those solutions which they propose. And they are unreasonable alternatives.

Last July, Alcan and Big Rivers agreed to plan (known as the Australian plan) whereby, when aluminum prices on the world market fell below a fixed amount, electric rates would be reduced accordingly. But when the price for aluminum went above that fixed point, the price of electricity would rise proportionately. Because Big Rivers' federal loan funds were cut off, Alcan agreed to sign loan notes on our behalf so that we could borrow the necessary operating funds whenever a shortage of funds at Big Rivers existed due to lower electricity prices to Alcan. This would be done on the theory that, when aluminum prices went back up, the loans could be paid off from extra revenues for electricity sold to Alcan. We sent NSA a copy of the proposal asking for their concurrence. NSA not only refused to sign the agreement, they threatened a lawsuit if we consummated the agreement with Alcan. Therefore, we reluctantly had to abandon that viable plan.

The truth of the matter is, very simply, that we are not in any position to subsidize NSA's power rates. As each of you knows, we have critical financial problems of our own. The various belt-tightening measures have made all of you personally, if not painfully, aware of our situation. We believe we have bent over backwards to help the aluminum industry in our service area. We continue to do what we can and what we think is right and fair for the aluminum industry, other industries, and our 72,000 commercial and residential consumers.

W.H. Thorpe

STATEMENT OF RICHARD D. HEMAN, JR., CHAIRMAN KENTUCKY PUBLIC SERVICE COMMISSION

The Kentucky Public Service Commission has regulatory jurisdiction over both the wholesale electric rates charged by Big Rivers and the quality of service it provides to its four distribution cooperatives.

The Kentucky Commission is deeply concerned about Big Rivers' lack of need for its D.B. Wilson generating plant and the resulting impairment of its financial condition. We are acutely aware that Big Rivers' financial health is greatly dependent upon that of two aluminum smelters owned by National Southwire Aluminum Co. and Alcan Aluminum Corp., which collectively purchase 70 percent of its electric generation. Big Rivers' rural load, consisting of residential, commercial and farm consumption, accounts for the remaining 30 percent of its sales.

The combination of this dependency on one industry and a relatively small rural load creates a complex and difficult framework within which the Wilson plant problem must be resolved. The ultimate disposition of the Wilson plant must reflect a delicate balance between the aluminum companies' need for electric rates that will enable their smelters to continue operating and the needs of Big Rivers' 70,000 other customers for rates that will not cripple the already depressed farming and mining communities in Big Rivers' service area.

The Kentucky Commission is clearly aware of Big Rivers' predicament. In April 1984, Big Rivers presented the Kentucky Commission with what at the time appeared to be a possible solution. Big Rivers' proposed to sell the Wilson plant to General Electric Credit Corporation with a simultaneous long-term leaseback. This sale/leaseback proposal was expected to produce a net savings to ratepayers of $700 million over a 35-year period. The sale/leaseback subsequently fell through when the Rural Electrification Administration (REA) refused to make available to Big Rivers the credit needed to complete the transaction. Shortly thereafter, REA refused to release loan funds it had committed to Big Rivers. REA then initiated a foreclosure suit in federal court.

In November 1984, Big Rivers sought relief to cover expenses not associated with the Wilson plant. Representatives of both residential customers and the aluminum industry actively opposed the request. The Kentucky Commission ultimately found that a rate increase was not necessary and ordered Big Rivers to negotiate with its two aluminum customers in an attempt to tie their electric rates to the price of aluminum.

The Kentucky Commission has been closely monitoring Big Rivers' financial and legal efforts to resolve the Wilson problem. The Commission has maintained continuous contact with Big Rivers. Commission representatives have attended negotiating sessions between Big Rivers and its bankers.

From the Kentucky Commission's perspective, it seems apparent that REA, as plaintiff in the foreclosure proceeding and Big Rivers' mortgagee, holds the key to any solution short of a reorganization under the bankruptcy laws. Unless REA is willing to accept some form of debt restructuring or reduction, or both, it does not appear that the present impass can be broken.

There appears to be three basic alternatives in this situation. First, REA can refuse to restructure Big Rivers' debt and force it into bankruptcy. Secondly, REA can try to force Big Rivers to place the Wilson unit into its rate base, thus driving Big Rivers' rates up substantially. The Kentucky Commission would have jurisdiction in this case and would look closely at whether the Wilson unit is used and useful for Big Rivers' ratepayers before allowing the plant into rate base. Even if Big Rivers were somehow able to add the Wilson unit to its rate base, the resulting higher rates would probably drive the aluminum industry out of business, thus forcing Big Rivers into bankruptcy and ending any possibility of REA collecting more than a fraction of the Big Rivers' debt.

The final alternate would require REA to restructure Big Rivers' debt and work much more closely with Big Rivers to make large, long-term sales of power from the Wilson unit or to sell all or part of the plant to other utilities. This is the only alternative that will both preserve the economy of Western Kentucky and permit the repayment of a substantial portion of Big Rivers' debt to REA.

The continuing uncertainty over the fate of Big Rivers is severely hampering any solution to the problem. In this climate of uncertainty, Big Rivers' efforts to sell power from the Wilson plant have been made doubly difficult. This uncertainty has clouded the future of Western Kentucky's aluminum industry, which must make critical decisions in the face of a steep decline in the prices for its products. If disaster is to be averted, REA must act, and act quickly.

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